Internal Revenue
bulletin

Bulletin No. 2002–26
July 1, 2002

HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 2002–38, page 4.
REIT noncustomary service income. Guidance is provided under sections 856 and 857(b)(7) of the Code for the situation when a REIT forms a taxable REIT subsidiary (TRS) to provide noncustomary services to tenants of the REIT and no service charges are separately stated from the rents paid by the tenants to the REIT.

T.D. 8997, page 6.
REG–122564–02, page 25.
Final and proposed regulations under section 1502 of the Code provide corporations filing consolidated returns with an election to waive the 5-year net operating loss carryback period with respect to certain acquired members.

T.D. 8998, page 1.
REG–123305–02, page 26.
Temporary and proposed regulations under sections 337(d) and 1502 of the Code clarify and amend certain aspects of the temporary regulations relating to the deductibility of losses recognized on dispositions of subsidiary stock by members of a consolidated group. The regulations apply to corporations filing consolidated returns, both during and after the period of affiliation, and also affect purchasers of the stock of members of a consolidated group. A public hearing on the proposed regulations is scheduled for July 17, 2002.

Rev. Proc. 2002–44, page 10.
Appeals mediation procedure. This document formally establishes the Appeals mediation procedure and modifies and expands the availability of mediation for cases that are already in the Appeals administrative process. Announcements 98–99 and 2001–9 superseded.

REG–248110–96, page 19.
Proposed regulations under section 817A of the Code affect insurance companies that define the interest rate to be used with respect to certain insurance contracts that guarantee higher returns for an initial, temporary period. Specifically, the proposed regulations define the appropriate interest rate to be used in the determination of tax reserves and required interest for certain modified guaranteed contracts. The proposed regulations also address how temporary guarantee periods that extend past the end of a taxable year are to be taken into account. A public hearing is scheduled for August 27, 2002.

EXCISE TAX

REG–106457–00, page 23.
Proposed regulations under section 4081 of the Code relate to the definition of diesel fuel and the application of the tax on blended taxable fuel.

Finding Lists begin on page ii.
Index for January through June begins on page vii.

Department of the Treasury
Internal Revenue Service

ADMINISTRATIVE

Announcement 2002–59, page 28.

New publications reflect tax law changes. The Service announces that four new publications are available reflecting changes enacted by the Job Creation and Worker Assistance Act of 2002. The new publications are: Publication 3991, *Highlights of the Job Creation and Worker Assistance Act;* Supplement to Publication 463, *Travel, Entertainment, Gift, and Car Expenses;* Supplement to Publication 536, *Net Operating Losses (NOLs) for Individuals, Estates, and Trusts;* and Supplement to Publication 946, *How To Depreciate Property.*

Announcement 2002–60, page 28.

Test of arbitration procedure for Appeals. This announcement extends the test of the arbitration procedures set forth in Announcement 2000–4, 2000–1 C.B. 317, for an additional one-year period. Announcement 2000–4 modified.

The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The first Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the first Bulletin of the succeeding semiannual period, respectively.

For sale by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 337.—Nonrecognition for Property Distributed to Parent in Complete Liquidation of Subsidiary

26 CFR 1.337(d)–2T: Loss limitation window period (temporary).

T.D. 8998

Loss Limitation Rules

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains amendments to temporary regulations issued under sections 337(d) and 1502. The amendments clarify certain aspects of the temporary regulations relating to the deductibility of losses recognized on dispositions of subsidiary stock by members of a consolidated group. The amendments in these temporary regulations apply to corporations filing consolidated returns, both during and after the period of affiliation, and also affect purchasers of the stock of members of a consolidated group. The text of these temporary regulations also serves as the text of the proposed regulations (REG–123305–02) set forth in this issue of the Bulletin.

DATES: *Effective Date*: These regulations are effective May 31, 2002.

Applicability Date: For dates of applicability see § 1.337(d)–2T(g) and 1.1502–20T(i).

FOR FURTHER INFORMATION CONTACT: Sean P. Duffley (202) 622–7530 or Lola L. Johnson (202) 622–7550 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these regulations has been previously reviewed and approved by the Office of Management and Budget under control number 1545–1774. Responses to this collection of information are voluntary. No material changes to this collection of information are made by these regulations.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to the collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

On March 12, 2002, the IRS and Treasury published in the **Federal Register** at 67 FR 11034 (T.D. 8984, 2002–13 I.R.B. 668) temporary regulations under sections 337(d) and 1502 (the temporary regulations). The temporary regulations set forth rules that limit the deductibility of loss recognized by a consolidated group on the disposition of stock of a subsidiary member and that require certain basis reductions on the deconsolidation of stock of a subsidiary member. Section 1.1502–20T(i) of the temporary regulations provides that, in the case of a disposition or deconsolidation of a subsidiary before March 7, 2002, and for such transactions effected pursuant to a binding written contract entered into before March 7, 2002, that was in continuous effect until the disposition or deconsolidation, a consolidated group may determine the amount of allowable stock loss or basis reduction by applying § 1.1502–20 in its entirety, § 1.1502–20 without regard to the duplicated loss component of the loss disallowance rule, or § 1.337(d)–2T. For dispositions and deconsolidations that occur on or after March 7, 2002, and that are not within the scope of the binding contract rule, § 1.1502–20T(i) provides that allowable loss and basis reduction are determined under § 1.337(d)–2T, not § 1.1502–20.

Explanation of Provisions

Since the publication of the temporary regulations, several questions have been raised concerning the interpretation and application of the temporary regulations. In response to these questions, the IRS and Treasury are promulgating the regulations in this Treasury decision as temporary regulations to clarify and amend the temporary regulations as described below in this preamble. The following paragraphs describe these amendments.

Netting Rule

Commentators requested that § 1.337 (d)–2T be amended to provide a netting rule similar to that set forth in § 1.1502–20(a)(4), pursuant to which gain and loss from certain dispositions of stock may be netted. This Treasury decision adds § 1.337(d)–2T(a)(4) to provide such a rule and also adds § 1.337(d)–2T(b)(4), which provides a similar netting rule for basis reductions on deconsolidations of subsidiary stock.

Time For Filing Election Described in § 1.1502–20T(i)

Section 1.1502–20T(i) currently provides that an election to determine allowable loss by applying § 1.1502–20 (without regard to the duplicated loss component of the loss disallowance rule) or § 1.337(d)–2T must be made by including a statement with or as part of the original return for the taxable year that includes the later of March 7, 2002, and the date of the disposition or deconsolidation of the stock of the subsidiary, or with or as part of an amended return filed before the date the original return for the taxable year that includes March 7, 2002, is due. Commentators noted that this provision may not permit the election to be made on an original return for the 2001 taxable year where the disposition occurs during the 2001 taxable year. The IRS and Treasury believe that it is appropriate to permit the election to be made on such a return. Therefore, this Treasury decision amends § 1.1502–20T(i) to provide that the statement may be filed with or as part of a timely filed (including any extensions) original return for any taxable year that includes any date on or before March 7, 2002. In addition, if the date of the disposition or deconsolidation of the stock of the subsidiary is after March 7, 2002, the statement may be filed with or as part of a timely filed (including any extensions) original return for the taxable year that includes such date. This latter alternative effectively permits the statement to be filed with the original return that includes the date of the disposition or deconsolidation if, as of March 7, 2002, the disposition or deconsolidation was subject to a binding written contract entered into before March 7, 2002, that was in continuous effect until the date of the disposition or deconsolidation.

Requirements for Perfecting Election Described in § 1.1502–20T(i)

Commentators questioned whether an election to determine allowable loss by applying § 1.1502–20 (without regard to the duplicated loss component of the loss disallowance rule) or § 1.337(d)–2T was valid only if a statement of allowed loss described in § 1.337(d)–2T(c) or 1.1502–20(c), as appropriate, was or is filed with respect to the disposition or deconsolidation of subsidiary stock. The amendments to the temporary regulations in this Treasury decision clarify that no statement other than the one described in § 1.1502–20T(i)(4) is necessary to perfect an election to compute allowable loss or basis reduction by applying the provisions described in § 1.1502–20T(i)(2)(i) or (ii). Therefore, an election pursuant to § 1.1502–20T(i) may be made regardless of whether a statement of allowed loss described in § 1.337(d)–2T(c) or 1.1502–20(c) was or is filed with respect to the disposition or deconsolidation.

In addition, taxpayers determining allowable loss under § 1.1502–20 in its entirety will generally be treated as having satisfied the requirement to file a statement of allowed loss otherwise imposed by § 1.1502–20(c) even if no such statement is filed. Nothing in the temporary regulations or these amendments to the temporary regulations, however, affects the filing requirements regarding the election provided in § 1.1502–20(g).

Effect of Election

Finally, a number of questions have been raised regarding the extent to which the election described in § 1.1502–20T(i) affects a taxpayer's items of income, gain, deduction, or loss other than the loss allowed on a disposition of subsidiary stock. In response to these questions, the temporary regulations are amended to explain that if, pursuant to an election under § 1.1502–20T(i), the loss allowed with respect to a disposition of subsidiary stock is increased, but the year of the disposition (or the year to which such loss would have been carried back or carried forward) is closed, to the extent that the absorption of such excess loss in such year would have affected the tax treatment of another item (*e.g.*, another loss that was absorbed in such year) that has an effect in an open year, the election will affect the treatment of such other item.

In addition, the regulations provide a special rule for situations in which a subsidiary of the group (the disposing member) recognized a loss on the disposition of stock of a lower-tier subsidiary member of the group, the loss was disallowed under § 1.1502–20, and, as a result, a group member's basis in the stock of the disposing member was reduced pursuant to § 1.1502–32 (because the disallowed loss was treated as a noncapital, nondeductible expense). In such cases, to the extent that all or some portion of the disallowed loss is allowed as a result of an election under § 1.1502–20T(i), but such loss would have been properly absorbed or expired in a closed year, the basis in the stock of the disposing member may be increased. This adjustment is to be made for purposes of determining the group's or the shareholder-member's Federal income tax liability for all open years.

Special Analyses

In light of the Federal Circuit's decision in *Rite Aid Corp. v. United States*, 255 F.3d 1357 (Fed. Cir. 2001), the temporary regulations were necessary to provide taxpayers with immediate guidance regarding allowable loss and basis reductions in connection with dispositions and deconsolidations of subsidiary stock and to carry out the principles of *General Utilities* repeal pending the issuance of further guidance. These amendments to the temporary regulations clarify those rules and simplify their application in order to ease taxpayer compliance. Accordingly, good cause is found for dispensing with notice and public procedure pursuant to 5 U.S.C. 553(b)(B) and with a delayed effective date pursuant to 5 U.S.C. 553(d)(1) and (3). It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required.

Drafting Information

The principal authors of these regulations are Sean P. Duffley and Lola L. Johnson, Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

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Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

Paragraph 1. The authority citation for part 1 is amended by removing the entry for "Section 1.1502–20T(i)" and adding an entry in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.1502–20T also issued under the authority of 26 U.S.C. 337(d) and 1502.

* * *

Par. 2. In § 1.337(d)–2T, paragraphs (a)(4) and (b)(4) are added to read as follows:

§ 1.337(d)–2T Loss limitation window period (temporary).

(a) * * *

(4) *Netting*. Paragraph (a)(1) of this section does not apply to loss with respect to the disposition of stock of a subsidiary, to the extent that, as a consequence of the same plan or arrangement, gain is taken into account by members with respect to stock of the same subsidiary having the same material terms. If the gain to which this paragraph applies is less than the amount of the loss with respect to the disposition of the subsidiary's stock, the gain is applied to offset loss with respect to

each share disposed of as a consequence of the same plan or arrangement in proportion to the amount of the loss deduction that would have been disallowed under paragraph (a)(1) of this section with respect to such share before the application of this paragraph (a)(4). If the same item of gain could be taken into account more than once in limiting the application of paragraphs (a)(1) and (b)(1) of this section, the item is taken into account only once.

(b) * * *

(4) *Netting*. Paragraph (b)(1) of this section does not apply to reduce the basis of stock of a subsidiary, to the extent that, as a consequence of the same plan or arrangement, gain is taken into account by members with respect to stock of the same subsidiary having the same material terms. If the gain to which this paragraph applies is less than the amount of basis reduction with respect to shares of the subsidiary's stock, the gain is applied to offset basis reduction with respect to each share deconsolidated as a consequence of the same plan or arrangement in proportion to the amount of the reduction that would have been required under paragraph (b)(1) of this section with respect to such share before the application of this paragraph (b)(4).

* * * * *

Par. 3. Section 1.1502–20T is amended by revising paragraphs (i)(3)(v) and (i)(4) to read as follows:

§ 1.1502–20T Disposition or deconsolidation of subsidiary stock (temporary).

* * * * *

(i) * * *

(3) * * *

(v) *Items taken into account in open years*—(A) *General rule*. An election under paragraph (i)(2) of this section affects a taxpayer's items of income, gain, deduction, or loss only to the extent that the election gives rise, directly or indirectly, to items or amounts that would properly be taken into account in a year for which an assessment of deficiency or a refund of overpayment, as the case may be, is not prevented by any law or rule of law. Under this paragraph, if the election increases the loss allowed with respect to a disposition of subsidiary stock, but the year of the disposition (or the year to which such loss would have been carried back or carried forward) is a year for which a refund of overpayment is prevented by law, to the extent that the absorption of such excess loss in such year would have affected the tax treatment of another item (*e.g.*, another loss that was absorbed in such year) that has an effect in a year for which a refund of overpayment is not prevented by any law or rule of law, the election will affect the treatment of such other item. Therefore, if the absorption of the excess loss in the year of the disposition (which is a year for which a refund of overpayment is prevented by law) would have prevented the absorption of another loss (the second loss) in such year and such loss would have been carried to and used in a year for which a refund of overpayment is not prevented by any law or rule of law (the other year), the election makes the second loss available for use in the other year.

(B) *Special rule*. If a member's basis in stock of a subsidiary was reduced pursuant to § 1.1502–32 because a loss with respect to stock of a lower-tier subsidiary was treated as disallowed under § 1.1502–20, then, to the extent such disallowed loss is allowed as a result of an election under paragraph (i) of this section but would have been properly absorbed or expired in a year for which a refund of overpayment is prevented by law or rule of law, the member's basis in the subsidiary stock may be increased for purposes of determining the group's or the shareholder-member's Federal income tax liability in all years for which a refund of overpayment is not prevented by law or rule of law.

* * * * *

(4) *Time and manner of making the election*. An election to determine allowable loss or basis reduction by applying the provisions described in paragraph (i)(2)(i) or (ii) of this section is made by including the statement required by this paragraph with or as part of any timely filed (including any extensions) original return for a taxable year that includes any date on or before March 7, 2002, or, if the date of the disposition or deconsolidation of the stock of the subsidiary is after March 7, 2002, then such date, or with or as part of an amended return filed before the date the original return for the taxable year that includes March 7, 2002, is due (including any extensions). Filing a statement in accordance with the provisions of this paragraph satisfies the requirement to file a "statement of allowed loss" otherwise imposed under § 1.1502–20(c)(3) or § 1.337(d)–2T(c)(3). The statement required by this paragraph satisfies the requirement that a statement be filed in order to claim allowable loss or basis reduction by applying the provisions described in paragraph (i)(2)(i) or (ii). The statement filed under this paragraph shall be entitled "Allowed Loss under Section [Specify Section under Which Allowed Loss Is Determined] Pursuant to Section 1.1502–20T(i)" and must include the following information—

(i) The name and employer identification number (E.I.N.) of the subsidiary and of the member(s) that disposed of the subsidiary stock;

(ii) In the case of an election to determine allowable loss or basis reduction by applying the provisions described in paragraph (i)(2)(i) of this section, a statement that the taxpayer elects to determine allowable loss or basis reduction by applying such provisions;

(iii) In the case of an election to determine allowable loss or basis reduction by applying the provisions described in paragraph (i)(2)(ii) of this section, a statement that the taxpayer elects to determine allowable loss or basis reduction by applying such provisions;

(iv) If an election described in § 1.1502–20(g) was made with respect to the disposition of the stock of the subsidiary, the amount of losses originally treated as reattributed pursuant to such election and the amount of losses treated as reattributed pursuant to paragraph (i)(3)(i) or (ii) of this section;

(v) If an apportionment of a separate section 382 limitation, a subgroup section 382 limitation, or a consolidated section 382 limitation is adjusted pursuant to paragraph (i)(3)(iii)(A), (B), or (C) of this section, the original and redetermined apportionment of such limitation; and

(vi) If the application of paragraph (i)(3)(i) or (ii) of this section results in a reduction of the amount of losses treated as reattributed pursuant to an election described in § 1.1502–20(g), a statement that the notification described in paragraph (i)(3)(iv) of this section was sent to the subsidiary and, if the acquirer was a member of a consolidated group at the time of the stock sale, to the person that was the common parent of such group at such time, as required by paragraph (i)(3)(iv) of this section.

* * * * *

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved May 20, 2002.

Pamela F. Olson,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on May 30, 2002, 8:45 a.m., and published in the issue of the Federal Register for May 31, 2002, 67 F.R. 37998)

Section 856.—Definition of Real Estate Investment Trust

(Also § 857.)

REIT noncustomary service income. Guidance is provided under sections 856 and 857(b)(7) of the Code when a REIT forms a taxable REIT subsidiary (TRS) to provide noncustomary services to tenants of the REIT and no service charges are separately stated from the rents paid by the tenants to the REIT.

Rev. Rul. 2002–38

ISSUE

If a real estate investment trust (REIT) forms a taxable REIT subsidiary (TRS) to provide noncustomary services to tenants of the REIT and no service charges are separately stated from the rents paid by the tenants to the REIT, how is the REIT's income from the services treated under §§ 856 and 857(b)(7) of the Internal Revenue Code?

FACTS

Situation 1

Corporation *R*, which has elected to be a REIT as defined in § 856, owns residential apartment buildings. *R* forms a wholly-owned subsidiary, corporation *T*, to provide housekeeping services to tenants of *R*'s apartment buildings. The services do not qualify as customary services under § 1.856–4(b)(1) of the Income Tax Regulations. *R* and *T* jointly elect under § 856(l) to treat *T* as a TRS of *R*.

Employees of *T* perform all of the housekeeping services received by *R*'s tenants, including administration and management of the services. *T* pays all costs of providing the services, such as its employees' salaries and the costs of their uniforms, equipment, and supplies. To carry out the housekeeping operations, *T* also rents space in *R*'s apartment buildings in accordance with § 856(d)(8)(A). *T* makes no payments to *R* other than its rental payments for that space. The annual value of the housekeeping services provided at each property exceeds one percent of the total annual amount received by *R* from the property.

Charges to the tenants for the housekeeping services are not separately stated from the rents that the tenants pay to *R* for the use of their apartments. *T* does not enter into contracts with the tenants for the performance of the housekeeping services. *R* compensates *T* for providing the services by paying *T* an amount that is 160 percent of *T's* direct cost of providing the services. *T* reports the full amount of *R*'s payment as gross income on *T's* federal income tax return.

Situation 2

The facts are the same as in *Situation 1* except that *R* compensates *T* for providing the services by paying *T* an amount that is 125 percent of *T*'s direct cost of providing the services, and that payment is less than the arm's length charge under § 482 for providing the services.

LAW

For taxable years beginning after December 31, 2000, §§ 856 and 857(b)(7) provide special rules for a corporation that is a TRS within the meaning of § 856(l). Those rules, which allow a TRS to provide noncustomary services to tenants of its REIT, govern the relationship between the REIT and the TRS.

To qualify as a REIT, an entity must derive at least 95 percent of its gross income from sources listed in § 856(c)(2) and at least 75 percent of its gross income from sources listed in § 856(c)(3). "Rents from real property" are among the sources listed in both of those sections. Section 856(d)(1) defines rents from real property to include rents from interests in real property, charges for services customarily rendered in connection with the rental of real property, and rent attributable to certain leased personal property. However, § 856(d)(2)(C) excludes "impermissible tenant service income" from the definition of rents from real property. Pursuant to § 856(d)(7)(A), impermissible tenant service income means, with respect to any real property, any amount received by a REIT for services rendered by the REIT to tenants of the property. Section 856(d)(7)(C)(i) provides that services rendered through a TRS are not treated as rendered by its REIT for purposes of § 856(d)(7)(A). Thus, services rendered by a TRS do not give rise to impermissible tenant service income.

Section 857(b)(7)(A) imposes for each taxable year of a REIT a tax equal to 100 percent of "redetermined rents." Section 857(b)(7)(B)(i) provides that redetermined rents mean rents from real property (as defined in § 856(d)) to the extent the amount of the rents would (but for § 857(b)(7)(E)) be reduced on allocation under § 482 to clearly reflect income as a result of services rendered by a TRS to a tenant of its REIT. Section 482 provides that when two or more organizations, trades, or businesses are owned or controlled directly or indirectly by the same interests (controlled organizations), the Secretary may allocate gross income between or among those controlled organizations if the Secretary determines that such allocation is necessary to clearly reflect the income of any of those controlled organizations. Pursuant to § 1.482–1(b)(1), the standard applied in determining the true taxable income of a controlled organization is that of an organization dealing at arm's length with an uncontrolled organization. Section 1.482–2(b)(3) defines an arm's length charge for services provided between controlled organizations, regardless of whether the services are an integral part of either organization's business activity (the § 482 arm's length charge). Section 857(b)(7)(E) provides that the imposition of tax under § 857(b)(7)(A) is in lieu of allocation under § 482.

Section 857(b)(7)(B)(ii) through (vii) contains exceptions, or safe harbors, from the 100 percent tax on redetermined rents. For example, pursuant to § 857(b)(7)(B)(vi), the definition of redetermined rents does not apply to any service rendered by a TRS to a tenant of its REIT if the gross income of the TRS from the service is at least 150 percent of the TRS's direct cost in rendering the service. Other safe harbors in § 857(b)(7)(B) cover customary services, services giving rise to *de minimis* amounts, services priced comparably to those provided by the TRS to unrelated persons, certain services with separately stated charges, and services excepted by the Secretary.

ANALYSIS

If a REIT forms a TRS to provide noncustomary services to the REIT's tenants and no service charges are separately stated from the tenants' rents, a primary question in determining the treatment of the REIT's income from the services is whether they are considered to be rendered by the REIT, or by the TRS, for purposes of § 856(d)(7). If rendered by the TRS and hence described in § 856(d)(7)(C)(i), the services do not give rise to impermissible tenant service income. All relevant facts and circumstances must be considered in determining the provider of the services for this purpose.

In *Situations 1* and *2*, charges to the tenants for the housekeeping services are not separately stated from the rents that the tenants pay to *R* for the use of their apartments. As a result, the amounts of the rents reflect the availability and use of those services. In other words, *R* receives greater rental payments than it would have received if the services had not been provided to its tenants. However, the structure of the 100 percent tax on redetermined rents indicates that Congress did not intend the lack of a separately stated service charge, by itself, to cause services to be treated as rendered by a REIT, rather than its TRS. In *Situations 1* and *2*, employees of *T* perform all of the housekeeping services received by *R*'s tenants, including administration and management of the services. *T* pays all costs of providing the services, such as its employees' salaries and the costs of their uniforms, equipment, and supplies. *T* also rents space to carry out the housekeeping operations and makes no payments to *R* other than its rental payments for that space. For purposes of § 856(d)(7)(C)(i), in those circumstances the services are considered to be rendered by *T*, rather than *R*, even though no service charges are separately stated from the tenants' rents. Accordingly, the services do not give rise to impermissible tenant service income and thus do not cause any portion of the rents received by *R* to fail to qualify as rents from real property under § 856(d).

As rents from real property, those rents are subject to being treated as redetermined rents under § 857(b)(7)(B)(i). That section provides that redetermined rents mean rents from real property (as defined in § 856(d)) to the extent the amount of the rents would (but for § 857(b)(7)(E)) be reduced on allocation under § 482 to clearly reflect income as a result of services rendered by a TRS to a tenant of its REIT. Section 482 allows the Secretary to allocate income from a REIT to its TRS to reflect the § 482 arm's length charge for the TRS's services. However, the 100 percent tax on redetermined rents is not imposed with respect to services described in a safe harbor of § 857(b)(7)(B).

In *Situation 1*, *R* compensates *T* for providing the housekeeping services by paying it an amount that is 160 percent of *T*'s direct cost of providing the services, and *T* reports the full amount of *R*'s payment as gross income on *T*'s federal income tax return. Pursuant to the safe harbor of § 857(b)(7)(B)(vi), the definition of redetermined rents does not apply to any service rendered by a TRS to a tenant of its REIT if the TRS's gross income from the service is at least 150 percent of its direct cost in rendering the service. In *Situation 1*, that safe harbor protects *R* from imposition of the 100 percent tax on redetermined rents. However, if the amount paid by *R* to *T* is less than the § 482 arm's length charge for providing the services, income is allocable from *R* to *T* under § 482 to reflect that charge. Section 857(b)(7)(E) does not preclude allocation under § 482 of income on which the 100 percent tax is not imposed. Income so allocated from *R* to *T* under § 482 would be deductible by *R* under § 162 and thus would reduce *R*'s taxable income, but not its gross income. Such allocation under § 482 would not cause any portion of the rents received by *R* to fail to qualify as rents from real property under § 856(d).

In *Situation 2*, *R* compensates *T* by paying it an amount that is 125 percent of *T*'s direct cost of providing the services, and that payment is less than the § 482 arm's length charge. In *Situation 2*, no safe harbor protects *R* from imposition of the 100 percent tax on redetermined rents. As a result, § 857(b)(7)(A) imposes on *R* a tax equal to the amount that would (but for imposition of that tax) be allocated under § 482 from *R* to *T* to reflect the § 482 arm's length charge for providing the services. In other words, the tax is equal to the amount by which the § 482 arm's length charge exceeds the payment from *R* to *T*. Pursuant to § 857(b)(7)(E), imposition of that tax is in lieu of allocation of the same amount from *R* to *T* under § 482. Imposition of that tax does not cause any portion of the rents received by *R* to fail to qualify as rents from real property under § 856(d).

HOLDINGS

(1) In *Situation 1*, the housekeeping services are considered to be rendered by *T*, rather than *R*, for purposes of § 856(d)(7)(C)(i). Accordingly, the services do not give rise to impermissible tenant service income and thus do not cause any portion of the rents received by *R* to fail to qualify as rents from real property under § 856(d). The safe harbor of § 857(b)(7)(B)(vi) protects *R* from imposition of the 100 percent tax on redetermined rents. However, if the amount paid by *R* to *T* represents less than the § 482 arm's length charge for providing the services, income is allocable from *R* to *T* under § 482. Income so allocated from *R* to *T* under § 482 would be deductible by *R* under § 162 and thus would reduce *R*'s taxable income, but not its gross income. Such allocation under § 482 would not cause any portion of the rents received by *R* to fail to qualify as rents from real property under § 856(d).

(2) In *Situation 2*, the housekeeping services are considered to be rendered by *T* for purposes of § 856(d)(7)(C)(i). Accordingly, the services do not give rise to impermissible tenant service income and thus do not cause any portion of the

rents received by *R* to fail to qualify as rents from real property under § 856(d). However, no safe harbor protects *R* from imposition of the 100 percent tax on redetermined rents. Section 857(b)(7)(A) imposes on *R* a tax equal to the amount by which the § 482 arm's length charge for providing the services exceeds the payment from *R* to *T*. Imposition of that tax is in lieu of allocation of that amount from *R* to *T* under § 482 and does not cause any portion of the rents received by *R* to fail to qualify as rents from real property under § 856(d).

DRAFTING INFORMATION

The principal author of this revenue ruling is Jonathan D. Silver of the Office of Associate Chief Counsel (Financial Institutions and Products). For further information regarding this revenue ruling, contact Mr. Silver at (202) 622–3920 (not a toll-free call).

Section 857.—Taxation of Real Estate Investment Trusts and Their Beneficiaries

If a REIT forms a taxable REIT subsidiary to provide noncustomary services to tenants of the REIT and no service charges are separately stated from the rents paid by the tenants to the REIT, how is the REIT's income from the services treated under section 857(b)(7). See Rev. Rul. 2002–38, page 4.

Section 1502.— Regulations

26 CFR 1.1502–21: Net operating losses.

T.D. 8997

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 602

Carryback of Consolidated Net Operating Losses to Separate Return Years

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains regulations under section 1502 that affect corporations filing consolidated returns. These regulations permit certain acquiring consolidated groups to elect to waive all or a portion of the pre-acquisition portion of the 5-year carryback period under section 172(b)(1)(H) for certain losses attributable to certain acquired members. The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking (REG–122564–02) on this subject in this issue of the Bulletin.

DATES: *Effective Date*: These temporary regulations are effective May 31, 2002.

Applicability Date: These regulations apply to consolidated net operating losses arising in taxable years ending during 2001 and 2002.

FOR FURTHER INFORMATION CONTACT: Marie Milnes-Vasquez of the Office of Associate Chief Counsel (Corporate), (202) 622–7770 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

These regulations are being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collection of information contained in these regulations has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget under control number 1545–1790. Responses to this collection of information are required to obtain a benefit.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

For further information concerning this collection of information, and where to submit comments on the collection of information and the accuracy of the estimated burden, and suggestions for reducing this burden, please refer to the preamble to the cross-referencing notice of proposed rulemaking published in the Proposed Rules section of the **Federal Register**.

Books or records relating to the collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

On July 2, 1999, the IRS and Treasury published in the **Federal Register** (64 FR 36092 (T.D. 8823, 1999–2 C.B. 34)) final regulations regarding certain deductions and losses of members that join a consolidated group. These regulations added § 1.1502–21(b)(3)(ii)(B), which permits an acquiring consolidated group to elect to waive, with respect to all consolidated net operating losses attributable to certain acquired members, the portion of the carryback period for which the corporation was a member of another group.

Section 172(b)(1) provides, in part, that a net operating loss for any taxable year must generally be carried back to each of the 2 taxable years preceding the taxable year of the loss. Section 172(b)(3) provides that any taxpayer entitled to a carryback period under section 172(b)(1) may elect to relinquish the carryback period with respect to a loss for any taxable year. An election to relinquish the carryback period under section 172(b)(3) must be made by the due date (including extensions) of the taxpayer's return for the taxable year of the loss and in the manner prescribed by the Secretary. Normally, this election is irrevocable.

Section 172(b)(1)(H), which was enacted as part of the Job Creation and Worker Assistance Act of 2002 (the Act), extended the 2-year carryback period to 5 years for losses arising in taxable years ending during 2001 and 2002 (hereafter, 2001 and 2002). Section 172(j), which was also enacted as part of the Act, allows a taxpayer entitled to the 5-year carryback period under section 172(b)(1)(H) to elect to relinquish that carryback period with respect to a loss for any taxable year. A taxpayer making this election generally must apply the 2-year carryback period set forth in section 172(b)(1), unless the taxpayer also elects to relinquish that carryback period under section 172(b)(3).

As described in Revenue Procedure 2002–40 (2002–23 I.R.B. 1096), in order to give effect to the intent of Congress to allow taxpayers a 5-year carryback period to the maximum extent possible, the Service is permitting any taxpayer that previously elected under section 172(b)(3) to forgo the carryback period for losses arising in 2001 or 2002 to revoke such election in order to take advantage of the 5-year carryback period, provided the taxpayer revokes the election no later than October 31, 2002. Revenue Procedure 2002–40 also permits a taxpayer that filed an application for a tentative carryback adjustment or an amended return using the 2-year carryback period for a net operating loss arising in 2001 or 2002 to file certain forms to claim the 5-year carryback period provided under section 172(b)(1)(H).

Given the enactment of section 172(b)(1)(H) and taxpayers' ability to revoke prior elections under section 172(b)(3) and to make certain other filings in order to take advantage of the 5-year carryback period, the IRS and Treasury believe that it is appropriate to afford certain acquiring consolidated groups that did not make an election described in § 1.1502–21(b)(3)(ii)(B) with respect to certain acquired members an opportunity to waive the portion of the entire carryback period or the portion of the extended carryback period for 2001 and 2002 losses attributable to the acquired members, for pre-acquisition years. In this regard, the regulations in this Treasury decision add § 1.1502–21T(b)(3)(ii)(C), which sets forth two elections.

Pursuant to the first election, an acquiring group may waive the portion of the 5-year carryback period for 2001 and 2002 losses attributable to a member acquired from another group after June 25, 1999, for which the member was a member of another group. While this election effectively permits a waiver of the entire 5-year carryback period to the extent that it is prior to the acquisition with respect to a consolidated net operating loss arising in a particular taxable year, it is only available where none of such losses have previously been carried back to a taxable year of a group of which the acquired member was previously a member.

Pursuant to the second election, an acquiring group may waive the portion of the pre-acquisition carryback period for 2001 and 2002 losses attributable to a member acquired from another group to the extent that the Act increased the carryback period for such losses. This second election effectively permits a waiver of the third, fourth, and fifth carryback years to the extent that such years are prior to the acquisition and is available even where 2001 or 2002 losses have been carried back to the first or second carryback years of the acquired member that are pre-acquisition years. This second election, however, is only available with respect to consolidated net operating losses arising in a particular taxable year where none of such losses have been carried back to a taxable year of a group of which the acquired member was previously a member that is prior to the second taxable year preceding the taxable year of the loss.

Unlike the election under § 1.1502–21(b)(3)(ii)(B), the elections provided in these regulations apply only to losses for 2001 and 2002. In addition, the elections are made on a year-by-basis. That is, one election may be made for 2001 losses while another election, or no election, may be made for 2002 losses. An election that relates to consolidated net operating losses attributable to a taxable year ending during 2001 must be filed with the acquiring consolidated group's timely filed (including extensions) original or amended return for the taxable year ending during 2001, provided that such original or amended return is filed on or before October 31, 2002. An election that relates to consolidated net operating losses attributable to a taxable year ending during 2002 must be filed with the acquiring consolidated group's timely filed (including extensions) original or amended return for the taxable year ending during 2001 or 2002, provided that such original or amended return is filed on or before September 15, 2003.

If the acquiring consolidated group files or filed a valid election described in § 1.1502–21(b)(3)(ii)(B) with respect to the acquisition of a member, no election under § 1.1502–21T(b)(3)(ii)(C) needs to be (or should be) filed to ensure that 2001 or 2002 losses are not carried back to pre-acquisition years of the acquired member.

Special Analyses

These temporary regulations are necessary to provide taxpayers with immediate elective relief from section 172(b)(1)(H), which was enacted as the part of the Job Creation and Worker Assistance Act of 2002. These regulations permit certain acquiring consolidated groups to elect to waive the 5-year carryback period with respect to certain acquired members. The regulations apply to losses arising in taxable years ending in 2001 and 2002. Based on these considerations, it is determined that this temporary regulation will provide taxpayers with the necessary guidance and authority to ensure equitable administration of the tax laws. Because of the need for immediate guidance, notice and public procedure are impracticable and contrary to the public interest pursuant to 5 USC 553(b)(B) and delayed effective date is not required pursuant to 5 USC 553(d)(1) and (3).

Further, it has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these temporary regulations is Marie Milnes-Vasquez. However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.1502–21T also issued under 26 U.S.C. 1502. * * *

Par. 2. Section 1.1502–21 is amended by adding paragraph (b)(3)(ii)(C) to read as follows:

§ 1.1502–21 Net operating losses.

* * * * *

(b) * * *

(3) * * *

(ii) * * *

(C) [Reserved]. For further guidance, see § 1.1502–21T(b)(3)(ii)(C).

* * * * *

Par. 3. Section 1.1502–21T is added to read as follows:

§ 1.1502–21T Net operating losses (temporary).

(a) through (b)(3)(ii)(B) [Reserved]. For further guidance, see § 1.1502–21(a) through (b)(3)(ii)(B).

(C) *Partial waiver of carryback period for 2001 and 2002 losses*—(1) *Application*. The acquiring group may make the elections described in paragraphs (b)(3)(ii)(C)(*2*) and (*3*) of this section with respect to an acquired member or members only if it did not file a valid election described in § 1.1502–21(b)(3)(ii)(B) with respect to such acquired member or members on or before May 31, 2002.

(*2*) *Partial waiver of entire pre-acquisition carryback period*. If one or more members of a consolidated group become members of another consolidated group after June 25, 1999, then, with respect to all consolidated net operating losses attributable to the member for the taxable year ending during either 2001 or 2002, or both, the acquiring group may make an irrevocable election to relinquish the portion of the carryback period for such losses for which the corporation was a member of another group, provided that any other corporation joining the acquiring group that was affiliated with the member immediately before it joined the acquiring group is also included in the waiver and that the conditions of this paragraph are satisfied. The acquiring group cannot make the election described in this paragraph with respect to any consolidated net operating losses arising in a particular taxable year if any carryback is claimed, as provided in paragraph (b)(3)(ii)(C)(*4*) of this section, with respect to any such losses on a return or other filing by a group of which the acquired member was previously a member and such claim is filed on or before the date the election described in this paragraph is filed. The election must be made in a separate statement entitled "THIS IS AN ELECTION UNDER SECTION 1.1502–21T(b)(3)(ii)(C)(*2*) TO WAIVE THE PRE-[insert first day of the first taxable year for which the member (or members) was a member of the acquiring group] CARRYBACK PERIOD FOR THE CNOLS ATTRIBUTABLE TO THE [insert taxable year of losses] TAXABLE YEAR(S) OF [insert names and employer identification numbers of members]." Such statement must be filed as provided in paragraph (b)(3)(ii)(C)(*5*) of this section.

(*3*) *Partial waiver of pre-acquisition extended carryback period*. If one or more members of a consolidated group become members of another consolidated group, then, with respect to all consolidated net operating losses attributable to the member for the taxable year ending during either 2001 or 2002, or both, the acquiring group may make an irrevocable election to relinquish the portion of the carryback period for such losses for which the corporation was a member of another group to the extent that such carryback period includes one or more taxable years that are prior to the taxable year that is 2 taxable years preceding the taxable year of the loss, provided that any other corporation joining the acquiring group that was affiliated with the member immediately before it joined the acquiring group is also included in the waiver and that the conditions of this paragraph are satisfied. The acquiring group cannot make the election described in this paragraph with respect to any consolidated net operating losses arising in a particular taxable year if a carryback to one or more taxable years that are prior to the taxable year that is 2 taxable years preceding the taxable year of the loss is claimed, as provided in paragraph (b)(3)(ii)(C)(*4*) of this section, with respect to any such losses on a return or other filing by a group of which the acquired member was previously a member and such claim is filed on or before the date the election described in this paragraph is filed. The election must be made in a separate statement entitled "THIS IS AN ELECTION UNDER SECTION 1.1502–21T(b)(3)(ii)(C)(*3*) TO WAIVE THE PRE-[insert first day of the first taxable year for which the member (or members) was a member of the acquiring group] EXTENDED CARRYBACK PERIOD FOR THE CNOLS ATTRIBUTABLE TO THE [insert taxable year of losses] TAXABLE YEAR(S) OF [insert names and employer identification numbers of members]." Such statement must be filed as provided in paragraph (b)(3)(ii)(C)(*5*) of this section.

(*4*) *Claim for a carryback*. For purposes of paragraphs (b)(3)(ii)(C)(*2*) and (*3*) of this section, a carryback is claimed with respect to a consolidated net operating loss if there is a claim for refund, an amended return, an application for a tentative carryback adjustment, or any other filing that claims the benefit of the net operating loss in a taxable year prior to the taxable year of the loss, whether or not subsequently revoked in favor of a claim based on a 5-year carryback period.

(*5*) *Time and manner for filing statement*. A statement described in paragraph (b)(3)(ii)(C)(*2*) or (*3*) of this section that relates to consolidated net operating losses attributable to a taxable year ending during 2001 must be filed with the acquiring consolidated group's timely filed (including extensions) original or amended return for the taxable year ending during 2001, provided that such original or amended return is filed on or before October 31, 2002. A statement described in paragraph (b)(3)(ii)(C)(*2*) or (*3*) of this section that relates to consolidated net operating losses attributable to a taxable year ending during 2002 must be filed with the acquiring consolidated group's timely filed (including extensions) original or amended return for the taxable year ending during 2001 or 2002, provided that such original or amended return is filed on or before September 15, 2003.

(iii) through (h) [Reserved]. For further guidance, see § 1.1502–21(b)(3)(iii) through (h).

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 4. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 5. In § 602.101, paragraph (b) is amended by adding an entry to the table in numerical order to read as follows:

§ 602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.1502–21T	1545–1790
* * * * *	

David A. Mader,
Acting Deputy Commissioner of Internal Revenue.

Approved May 20, 2002.

Pamela F. Olson,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on May 30, 2002, 8:45 a.m., and published in the issue of the Federal Register for May 31, 2002, 67 F.R. 38000)

Section 7123.—Appeals Dispute Resolution Procedures

The revenue procedure formally establishes the Appeals Mediation Procedure, and modifies and expands the availability of mediation for cases that are already in the Appeals administrative process. *See* section 7123(b)(1) and Rev. Proc. 2002–44, page 10.

The announcement extends the test of the arbitration procedures set forth in Announcement 2000–4, 2000–1 C.B. 317, for an additional one-year period. *See* section 7123(b)(2) and Announcement 2002–60, page 28.

Part III. Administrative, Procedural, and Miscellaneous

26 CFR 601.106: Appeals functions.
(Also §§ 601.202, 601.203; and Part I, § 7123(b)(1).)

Rev. Proc. 2002–44

CONTENTS

SECTION 1. PURPOSE

On January 15, 2002, Appeals completed an additional one-year test of its mediation procedure. *See* Announcement 2001–9, 2001–1 C.B. 357. This revenue procedure formally establishes the Appeals mediation procedure; and modifies and expands the availability of mediation for cases that are already in the Appeals administrative process.

This revenue procedure supersedes Announcement 98–99, 1998–2 C.B. 650, and Announcement 2001–9.

SECTION 2. BACKGROUND

The mission of Appeals is to resolve tax controversies, without litigation, on a basis which is fair and impartial to both the Government and the taxpayer. Mediation is an extension of the Appeals process and will enhance voluntary compliance. Mediation is a nonbinding process that uses the services of a mediator, as a neutral third party, to help Appeals and the taxpayer reach their own negotiated settlement. (References herein to "mediator" include any non-Internal Revenue Service co-mediator, as appropriate (*see* sections 5.06 and 5.08 of this revenue procedure). To accomplish this goal, the mediator will act as a facilitator, assist in defining the issues, and promote settlement negotiations between Appeals and the taxpayer. The mediator will not have settlement authority in the mediation process and will not render a decision regarding any issue in dispute. The mediator should inform and discuss with Appeals and the taxpayer the rules and procedures concerning the mediation process.

Section 7123(b)(1) of the Internal Revenue Code, as enacted by § 3465 of the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105–206, 112 Stat. 685, provides for expansion of the Appeals mediation program. The Service previously allowed taxpayers to request mediation for factual issues involving an adjustment of $1 million or more that were already in the Appeals administrative process. *See* Announcements 98–99 and 2001–9.

SECTION 3. SIGNIFICANT CHANGES

The mediation procedure has been modified, and expanded to allow for additional cases in Appeals to be eligible for mediation. Significant changes to Announcements 98–99 and 2001–9 made by this revenue procedure include:

.01 Mediation is no longer limited to issues involving an adjustment of $1 million or more; it is now available for any qualifying issues, as described in this revenue procedure, that are already in the Appeals administrative process;

.02 Section 4.02(1) provides that legal issues are now eligible for mediation;

.03 Section 4.02(3) provides that Industry Specialization Program (ISP) issues and Appeals Coordinated Issues (ACI) are now eligible for mediation;

.04 Section 4.02(5) provides that mediation is now available for an issue for which the taxpayer intends to seek competent authority assistance, provided a request for competent authority assistance has not as yet been filed;

.05 Section 4.02(6) provides that mediation is now available after unsuccessful attempts to enter into a closing agreement under § 7121;

.06 Section 4.03(2) provides that Collection cases are excluded from mediation;

.07 Section 4.03(3) provides that issues for which mediation would not be consistent with sound tax administration are excluded from mediation;

.08 Section 4.03(4) provides that frivolous issues are excluded from mediation;

.09 Section 4.03(5) provides that cases where the taxpayer did not act in good faith during settlement negotiations are excluded from mediation;

.10 Section 5.02(2) includes new filing requirements;

.11 Section 5.04 includes express timelines to complete the agreement to mediate and proceed to mediation. A taxpayer's inability to adhere to these timeframes, without reasonable cause, may result in Appeals' withdrawal from the mediation process;

.12 Section 5.06 requires the use of Appeals personnel who are trained mediators. Headquarters Appeals will pay the expenses associated with Appeals mediators. Taxpayers may also elect to use a non-Internal Revenue Service mediator, at taxpayers' expense;

.13 Section 5.11 provides that there will be no *ex parte* contacts with the mediator outside the mediation session, except as provided by that section;

.14 Section 5.16 provides that if the taxpayer and Appeals do not reach an agreement on an issue being mediated, they may then request arbitration for the issue provided the mediation issue meets the requirements for arbitration and the taxpayer acted in good faith during the mediation process.

SECTION 4. SCOPE OF MEDIATION

.01 *In general*. The mediation procedure will attempt to resolve issues in cases that qualify under this revenue procedure while they are in the jurisdiction of Appeals. This procedure may be used only after Appeals settlement discussions are unsuccessful, and, generally, when all other issues are resolved but for the issue(s) for which mediation is being requested.

.02 *Applicability*. Mediation is available for:

(1) Legal issues;

(2) Factual issues;

(3) An Industry Specialization Program (ISP) issue or an Appeals Coordinated Issue (ACI). [ISP issues are listed in Exhibit 8.7.1–1, and ACI issues are listed in section 8.7.1–3, of the Internal Revenue Manual.] However, an ISP or ACI issue will not be eligible for mediation when the taxpayer has declined the opportunity to discuss the ISP or ACI issue with the Appeals ISP or ACI coordinator during the course of the Appeals settlement discussions;

(4) An early referral issue when an agreement is not reached, provided the early referral issue meets the requirements for mediation (*see* section 2.16 of Rev. Proc. 99–28, 1999–2 C.B. 109, or any subsequent revenue procedure);

(5) Mediation is now available for an issue for which the taxpayer intends to seek competent authority assistance, provided a request for competent authority assistance has not as yet been filed. In such a case, the taxpayer may not request competent authority assistance until the mediation process is completed. However, competent authority assistance may be requested while mediation is pending if such request is necessary to keep open a statute of limitations in the treaty country. In such a case, the U.S. competent authority will suspend action on the case until mediation is competed. Mediation is not available for an issue for which the taxpayer has requested competent authority assistance or the simultaneous Appeals/Competent Authority procedure described in section 8 of Rev. Proc. 96–13, 1996–1 C.B. 616, or any subsequent revenue procedure. **Taxpayers are cautioned that if they enter into a settlement with Appeals (including an Appeals settlement through the mediation process), and then request competent authority assistance, the U.S. competent authority will endeavor only to obtain a correlative adjustment with the treaty country and will not take any actions that would otherwise amend the settlement. *See* section 7.05 of Rev. Proc. 96–13; and**

(6) Unsuccessful attempts to enter into a closing agreement under § 7121.

.03 *Inapplicability*. Mediation will not be available for:

(1) An issue designated for litigation or docketed in any court. [For the Chief Counsel mediation program involving issues in docketed cases, see Chief Counsel Directives Manual (CCDM)(35) 3(20)0];

(2) Collection cases;

(3) Issues for which mediation would not be consistent with sound tax administration, *e.g.* issues governed by closing agreements, by *res judicata*, or controlling Supreme Court precedent;

(4) Frivolous issues, such as, but not limited to, those identified in Rev. Proc. 2001–41, 2001–33 I.R.B.173; and

(5) Cases where the taxpayer did not act in good faith during settlement negotiations, *e.g.*, failure to respond to document requests, failure to respond timely to offers to settle, failure to address arguments and precedents raised by Appeals.

SECTION 5. MEDIATION PROCESS

.01 *Mediation is optional*. A taxpayer and an Appeals Team Case Leader or Appeals Officer may request mediation after consultation with each other.

.02 *Filing requirements.*

(1) *Where to file*. The taxpayer seeks approval for mediation by sending a written request to the appropriate Appeals Team Manager. The taxpayer should also send a copy of the written request to the appropriate Appeals Area Director and to the Chief Appeals, 1099 14th Street, NW, Suite 4200 — East, Washington, DC 20005, Attn: Appeals LBSP Operations. (See Exhibit 1 of this revenue procedure for a listing of the addresses for each Appeals Area Director.)

(2) *Required information*. The mediation request should:

(a) Provide the taxpayer's name, TIN, address and the name, title, address and telephone number of a person to contact;

(b) Provide the Team Case Leader's or Appeals Officer's name;

(c) Identify the taxable period(s) involved;

(d) Describe the issue for which mediation is being requested, including the dollar amount of the adjustment in dispute; and

(e) Contain a representation that the issue is not an excluded issue listed in the "Scope of Mediation" section above.

.03 *Review of Mediation Request*. Generally, the Appeals Team Manager will respond to the taxpayer and the Team Case Leader or Appeals Officer within two weeks after the Appeals Team Manager receives the taxpayer's request for mediation.

(1) *Request approved*. If Appeals approves the mediation request, the Appeals Team Manager will inform the taxpayer and the Team Case Leader or Appeals Officer, and schedule a conference or conference call that may include a representative from Appeals LBSP Operations, Headquarters Appeals — to discuss the mediation process.

(2) *Request denied*. If Appeals denies the mediation request, the Appeals Team Manager will promptly inform the taxpayer and the Team Case Leader or Appeals Officer. Although no formal appeal procedure exists for the denial of a mediation request, a taxpayer may request a conference with the Appeals Team Manager to discuss the denial. The denial of a mediation request is not subject to judicial review.

.04 *Agreement to mediate*. The taxpayer and Appeals will enter into a written agreement to mediate. See Exhibit 2 of this revenue procedure for a model agreement to mediate. This agreement will be negotiated at an administrative conference or conference call — that may include a representative from Appeals

LBSP Operations, Headquarters Appeals. The agreement to mediate: (a) should be as concise as possible, (b) will specify the issue(s) that the parties have agreed to mediate, and (c) should identify the location and the proposed date of the mediation session.

The Appeals Team Manager, in consultation with the Team Case Leader or Appeals Officer, will sign the agreement to mediate on behalf of Appeals.

Generally, it is expected that the parties will complete the agreement to mediate within three weeks after being notified that Appeals approved the mediation request and proceed to mediation within 60 days after signing the agreement to mediate. A taxpayer's inability to adhere to these timeframes, without reasonable cause, may result in Appeals' withdrawal from the mediation process.

.05 *Participants*. The parties to the mediation process will be the taxpayer and Appeals. Absent an agreement to the contrary, each party must have at least one participant attending the mediation session with decision-making authority. The mediation agreement will set forth the procedures by which the parties inform the other party and the mediator of the participants in the mediation and will set forth any limitation on the number, identity or participation by such participants. In general, the parties are encouraged to include, in addition to the required decision-makers, those persons with information and expertise that will be useful to the decision-makers and the mediator. In order to minimize the possibility of a last-minute disqualification of the mediator, each party must notify the mediator and the other party no later than two weeks before the mediation, regarding the participants on their mediation team. See Exhibit 3 of this revenue procedure for a model participants list.

.06 *Selection of mediator and expenses*. The taxpayer and the Appeals Team Manager will select the mediator. A representative from Appeals LBSP Operations, Headquarters Appeals may participate in an administrative conference or conference call to discuss the selection of the mediator by the parties. A mediator shall have no official, financial, or personal conflict of interest with respect to the parties, unless such interest is fully disclosed in writing to the taxpayer and the Appeals Team Manager, and they agree that the mediator may serve. *See* 5 U.S.C. § 573.

This mediation procedure requires the use of an Appeals employee who is a trained mediator. Headquarters Appeals will pay the expenses associated with the Appeals mediator. The taxpayer may also elect to use a non-Internal Revenue Service co-mediator, at the taxpayer's expense.

.07 *Appeals personnel as mediators and conflict statement*. The taxpayer and the Appeals Team Manager will select an Appeals mediator from a list of eligible individuals who, generally, will be from the same Appeals office or geographic area, but not the same group, where the case is assigned.

Due to the inherent conflict that results because the Appeals mediator is an employee of the IRS, the Appeals mediator will provide to the taxpayer a statement confirming his/her proposed service as a mediator, that he/she is a current employee of the IRS, that a conflict results from his/her continued status as an IRS employee, and that this conflict will not interfere in the mediator's ability to impartially facilitate the case. The written agreement to mediate will include this statement.

.08 *Criteria for selection of non-Internal Revenue Service co-mediator*. If the taxpayer elects to use a non-Internal Revenue Service co-mediator, the taxpayer and the Appeals Team Manager should make the selection from any local or national organization that provides a roster of neutrals. Criteria for selecting a non-Internal Revenue Service co-mediator may include: completion of mediation training, previous mediation experience, a substantive knowledge of tax law, or knowledge of industry practices.

.09 *Discussion summaries*. Each party will prepare a discussion summary of the issues (including the party's arguments in favor of the party's position) for consideration by the mediator. The discussion summaries should be submitted to the mediator and the other party no later than two weeks before the mediation session is scheduled to begin.

.10 *Confidentiality*. The mediation process is confidential. Therefore, all information concerning any dispute resolution communication is confidential and may not be disclosed by any party, participant, observer or mediator except as provided by statute, such as in § 6103 of the Internal Revenue Code and 5 U.S.C § 574. A dispute resolution communication includes all oral or written communications prepared for the purposes of a dispute resolution proceeding. *See* 5 U.S.C. § 571(5).

In executing the mediation agreement, the taxpayer consents under § 6103(c) to the disclosure by the IRS of the taxpayer's returns and return information incident to the mediation to any participant or observer identified in the initial lists of participants and observers and to any subsequent participants and observers identified in writing by the parties. (*See* section 5.05 of this revenue procedure.) If the mediation agreement is executed by a person pursuant to a power of attorney executed by the taxpayer, that power of attorney must clearly express the taxpayer's grant of authority to consent to disclose the taxpayer's returns and return information by the IRS to third parties, and a copy of that power of attorney must be attached to the agreement.

IRS and Treasury employees who participate in or observe the mediation process in any way, and any person under contract to the IRS pursuant to § 6103(n) that the IRS invites to participate or observe, will be subject to the confidentiality and disclosure provisions of the Internal Revenue Code, including §§ 6103, 7213, and 7431.

.11 *Ex Parte Contacts Prohibited*. To ensure that one party is not in a position to exert undue influence on the mediator, there will be no *ex parte* contacts with the mediator outside the mediation session.

The prohibition against *ex parte* communications is intended to apply only to unsolicited contacts from one of the parties outside the mediation session. It ensures the mediator does not receive information or evidence the other party is unaware of and is unable to respond to or rebut.

This provision does not prevent the mediator from contacting a party, or a party from answering a question or request posed by the mediator.

.12 *Section 7214(a)(8) disclosure*. Under § 7214(a)(8), IRS employees must report information concerning violations of any revenue law to the Secretary. The agreement to mediate will state this requirement and the parties will acknowledge this duty.

.13 *Disqualification of the non-Internal Revenue Service co-mediator*. The non-Internal Revenue Service co-mediator will be disqualified from representing the taxpayer in any pending or future action that involves the transactions or issues that are the particular subject matter of the mediation. This disqualification extends to representing any other parties involved in the transactions or issues that are the particular subject matter of the mediation. Moreover, the mediator's firm will be disqualified from representing the taxpayer or any other parties involved in the transactions or issues that are the particular subject matter of the mediation in any action that involves the transactions or issues that are the particular subject matter of the mediation.

The mediator's firm will not be disqualified from representing the taxpayer or any other parties in any future action that involves the same transactions or issues that are the particular subject matter of the mediation, provided that (i) the mediator disclosed the potential of such representation to the parties to the mediation conducted by the mediator prior to the parties' acceptance of the mediator, (ii) such action relates to a taxable year that is different from the taxable year that is the subject matter of the mediation, (iii) the firm's internal controls preclude the mediator from any form of participation in the matter, and (iv) the firm does not apportion to the mediator any part of the fee therefrom. In the event the mediator has been selected prior to the mediator learning of the identity of one or more of the parties involved in the mediation, requirement (i) will be deemed satisfied if the mediator promptly notifies the parties of the potential representation.

While the mediator may not receive a direct allocation of the fee from the taxpayer (or other party) in the matter for which the internal controls are in effect, the mediator will not be prohibited from receiving a salary, partnership share, or corporate distribution established by prior independent agreement. The mediator and his or her firm are not disqualified from representing the taxpayer or any other parties involved in the mediation in any matters unrelated to the transactions or issues that are the particular subject matter of the mediation.

This paragraph 12 only applies to representations on matters before the IRS.

The provisions of this paragraph 12 are in addition to any other applicable disqualification provisions including, for example, the rules of the United States Tax Court and applicable canons of ethics.

.14 *Withdrawal*. Either party may withdraw from the process anytime before reaching a settlement of the issues being mediated by notifying the other party and the mediator in writing.

.15 *Mediator's report*. At the conclusion of the mediation process, the mediator will prepare a brief written report and submit a copy to each party. See Exhibit 4 of this revenue procedure for a model mediator's report.

.16 *Appeals procedures apply*. If the parties reach an agreement on all or some issues through the mediation process, Appeals will use established procedures, including preparation of a Form 906, *Closing Agreement on Final Determination Covering Specific Matters*. *See* Statement of Procedural Rules, 26 C.F.R. § 601.106. Delegation Order 236 (Rev. 3) may apply to settlements resulting from the mediation process.

If the parties do not reach an agreement on an issue being mediated, they may request arbitration for the issue, provided the mediation issue meets the requirements for arbitration. *See* Announcement 2002–60, 2002–26 I.R.B. 28, or any subsequent procedure. If arbitration is not requested or approved, Appeals will not reconsider the mediated issue(s), and a statutory notice of deficiency will be issued with respect to all unagreed issues; or for non-deficiency cases, they will be processed using established closing procedures.

.17 *Use as precedent*. A settlement reached by the parties through mediation will not be binding on the parties (or be otherwise controlling) for taxable years not covered by the agreement. Except as provided in the agreement, any party may not use such settlement as precedent.

SECTION 6. EFFECTIVE DATE

This procedure is effective July 1, 2002, the date this revenue procedure is published in the Internal Revenue Bulletin.

SECTION 7. EFFECT ON OTHER DOCUMENTS

Announcement 98–99 and Announcement 2001–9 are superseded.

DRAFTING INFORMATION

The principal author of this revenue procedure is Sandy Cohen, of the office of Appeals Large Business and Specialty Programs — Operations, Headquarters Appeals. For further information regarding this revenue procedure, contact Mr. Cohen at (202) 694–1818 (not a toll-free call).

Exhibit 1:

Addresses for Appeals Area Directors

Appeals Large Business and Specialty Programs (LBSP) Operating Unit

Director, Appeals LBSP Area 1
290 Broadway
New York, NY 10007

Director, Appeals LBSP Area 2
8701 South Gessner Road
Houston, TX 77074

Director, Appeals LBSP Area 3
200 W. Adams Street
Chicago, IL 60606

Director, Appeals LBSP Area 4
1650 Mission Street
San Francisco, CA 94103

Director, Appeals LBSP Specialty Programs
1222 Spruce Street
St. Louis, MO 63103

General Appeals Operating Unit

Director, General Appeals Area 1
290 Broadway
New York, NY 10007

Director, General Appeals Area 2
31 Hopkins Plaza
Baltimore, MD 21201

Director, General Appeals Area 3
575 North Pennsylvania Street
Indianapolis, IN 46204

Director, General Appeals Area 4
810 Broadway
Nashville, TN 37203

Director, General Appeals Area 5
4050 Alpha Road
Dallas, TX 75244

Director, General Appeals Area 6
160 Spear Street
San Francisco, CA 94105

Director, General Appeals Area 7
24000 Avila Road
Laguna Nigel, CA 92677

Exhibit 2:

Model Agreement to Mediate

1. *The Mediation Process.*

The mediation will be an extension of the Appeals process to help [**NAME OF TAXPAYER**] and Internal Revenue Service (IRS)—Appeals (the PARTIES) reach their own negotiated settlement of the issues to be mediated. See (2) below for the participants in the mediation process. To accomplish this goal, the mediator will act as a facilitator, assist in defining the issues and promote settlement negotiations between the PARTIES. The mediator will inform and discuss with the PARTIES the rules and procedures pertaining to the mediation process. The mediator will not have settlement authority and will not render a decision regarding any issue in dispute. The PARTIES will continue to have settlement authority for all issues considered under the mediation process.

2. *Nature of Process, Participants, Withdrawal.*

(a) The mediation process is optional.

(b) Each PARTY must have at least one participant attending the mediation session with decision-making authority. No later than two weeks before the mediation, each PARTY will submit to the other PARTY and the mediator a list of the participants who will attend the mediation session on behalf of or at the request of the PARTY, including a designation of the person with decision-making authority who will represent the PARTY at the mediation session. Each PARTY's list of participants will contain the participant's name, the participant's position with the PARTY or other affiliation (*e.g.*, a member of the XYZ law firm, counsel to the taxpayer), and the participant's address, [telephone number and fax number]. All participants attending the mediation on behalf of or at the request of a PARTY will be listed on the PARTY's list of participants, including witnesses, consultants, and attorneys.

[Insert limitations on the number or types of participants, if any.]

(c) Either PARTY may withdraw from the process at any time prior to reaching a settlement of the issues to be mediated by notifying the other PARTY and the mediator in writing.

3. *Selection of Mediator and Costs.*

(a) [**NAME OF TAXPAYER**] and [**NAME**], Appeals Team Manager will select an Appeals mediator. If the taxpayer elects to use a non-IRS co-mediator, the taxpayer and the Appeals Team Manager should make the selection from any local or national organization that provides a roster of neutrals. Criteria for selecting a non-IRS co-mediator may include: completion of mediation training, previous mediation experience, a substantive knowledge of tax law, or knowledge of industry practices. A potential mediator must disclose any official, financial, or personal conflict of interest with respect to the PARTIES. Any potential mediator with any such conflict of interest may not serve as a mediator, unless such interest is fully disclosed in writing to the PARTIES and they agree that the mediator may serve. *See* 5 U.S.C. § 573.

(b) Headquarters Appeals will pay the costs associated with the Appeals mediator. The taxpayer may elect to use a non-Internal Revenue Service co-mediator, at the taxpayer's expense.

(c) Due to the inherent conflict that results because the Appeals mediator is an employee of the IRS, the Appeals mediator will provide to the taxpayer a statement confirming his/her proposed service as a mediator, that he/she is a current employee of the IRS, and that a conflict results from his/her continued status as an IRS employee.

4. *Issues to be Mediated.*

The mediation session will encompass the following issues in the IRS audit of [**NAME OF TAXPAYER**]'s federal tax returns for tax year(s) __________:

(a) Issue #1
(b) Issue #2

5. *Submission of Materials.*

Each PARTY will present to the mediator a separate written summation not to exceed 20 pages (exclusive of exhibits consisting of pre-existing documents and reports) regarding each issue. The mediator will have the right to ask either PARTY for additional information before the mediation session if deemed necessary for a full understanding of the issues to be mediated. Each PARTY will simultaneously submit a copy of any submission that it gives to the mediator to the other party.

6. *Place of Mediation.*

The PARTIES should attempt to select a site at or near the mediator's office, [**NAME OF TAXPAYER**]'s office, or an Appeals office.

7. *Proposed Schedule.*

Subject to the approval of the mediator, the mediation session will be conducted according to the following schedule:

Submission of Materials to Mediator:	***A DATE, WHICH IS NOT LATER THAN TWO WEEKS BEFORE THE DATE OF MEDIATION SESSION***
Mediation Session:	***By MONTH DAY, YEAR and TIME***

8. *Confidentiality.*

IRS and Treasury employees who participate in or observe the mediation process in any way, and any person under contract to the IRS pursuant to § 6103(n) of the Internal Revenue Code, including the mediator, that the IRS invites to participate or observe, will be subject to the confidentiality and disclosure provisions of the Internal Revenue Code, including §§ 6103, 7213, and 7431. *See* also 5 U.S.C § 574.

[**NAME OF TAXPAYER**] consents, under § 6103(c), to the disclosure by the IRS of the taxpayer's returns and return information incident to the mediation to any participant or observer identified in the list of participants. If the mediation agreement is executed by a person pursuant to a power of attorney executed by [**NAME OF TAXPAYER**], that power of attorney must clearly express the grant of authority by [**NAME OF TAXPAYER**] to consent to disclose the returns and return information of [**NAME OF TAXPAYER**] by the IRS to third parties. A copy of that power of attorney must be attached to this agreement.

9. *Ex Parte Contacts Prohibited.*

There will be no *ex parte* contacts from a party to the mediator outside the mediation session. This provision is not intended to prevent the mediator from contacting a party, or a party from responding to the mediator's request for information.

10. *Section 7214(a)(8) Disclosure.*

The PARTIES to this agreement acknowledge that IRS employees involved in this mediation are bound by the § 7214(a)(8) disclosure requirements concerning violations of any revenue law.

11. *No Record.*

There will be no stenographic record, no audio or video tape recording or other transcript of the mediation session(s).

12. *Report by Mediator.*

At the conclusion of the mediation session, the mediator will issue a brief report to the PARTIES identifying each issue described in section 4, above, and whether the PARTIES either agreed to resolve or did not resolve the issue.

13. *Appeals Procedures Apply.*

If the mediation process enables the PARTIES to reach agreement on the issues, Appeals will use established procedures to close the case. Delegation Order 236 (Rev. 3) may apply to settlements resulting from the mediation process. If the parties do not reach an agreement on an issue being mediated, the parties may request arbitration for the issue, provided the mediation issue meets the requirements for arbitration. *See* Announcement 2002–60, 2002–26 I.R.B. 28, or any subsequent procedure. If arbitration is not requested or approved, Appeals will not reconsider the mediated issue(s), and a statutory notice of deficiency will be issued with respect to all unagreed issues; or for non-deficiency cases, they will be processed using established closing procedures.

14. *Precedential Use.*

A settlement reached by the PARTIES through mediation will not be binding on the parties (or be otherwise controlling) for taxable years not covered by the agreement. Except as provided in the agreement, any PARTY may not use such settlement as precedent.

INTERNAL REVENUE SERVICE, APPEALS	NAME OF TAXPAYER
By:________________________	By:________________________
NAME	NAME
Appeals Team Manager	TITLE
Date:________________________	Date:________________________

Exhibit 3:

Model Mediation Participants List

Case Name:______________________________

Submitted By:______________________________

Date:______________________________

Please list below *all* participants attending the mediation, including witnesses, consultants, and attorneys. This form must be sent to the other PARTY and to the mediator(s) no later than two weeks before the mediation session. Insert an **asterisk (*)** before the name of the person who has decision-making authority at the mediation session:

NAME	***POSITION OR AFFILIATION***	***ADDRESS***	***TELEPHONE & FAX NUMBER***

Exhibit 4:

Model Mediator's Report

The parties below agreed to mediate their dispute and attended a mediation session on **MONTH DAY, YEAR** in an attempt to settle the following issue(s):

ISSUE:	
SETTLEMENT:	[ ] Yes
	[ ] No
	[ ] Partial

ISSUE:	
SETTLEMENT:	[ ] Yes
	[ ] No
	[ ] Partial

Settlement documents will be prepared under established Appeals procedures.

DATED this _______ day of _______________

____
/s/ Mediator

____
/s/ Party

____
/s/ Party

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Guidance Under Section 817A Regarding Modified Guaranteed Contracts

REG–248110–96

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations affecting insurance companies that define the interest rate to be used with respect to certain insurance contracts that guarantee higher returns for an initial, temporary period. Specifically, the proposed regulations define the appropriate interest rate to be used in the determination of tax reserves and required interest for certain modified guaranteed contracts. The proposed regulations also address how temporary guarantee periods that extend past the end of a taxable year are to be taken into account. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by August 20, 2002. Requests to speak (with outlines of oral comments to be discussed) at the public hearing scheduled for August 27, 2002, at 10 a.m., must be received by August 6, 2002.

ADDRESSES: Send submissions to: CC:ITA:RU (REG–248110–96), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Comments may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to CC:ITA:RU (REG–248110–96), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may submit comments electronically directly to the IRS internet site at: *http://www.irs.gov/regs*. The public hearing will be held in Room 4718, 1111 Constitution, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Ann H. Logan, 202–622–3970. Concerning the hearing, LaNita Van Dyke of the Regulations Unit, 202–622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

History

Section 817A was added by section 1612 of the Small Business Job Protection Act of 1996, Public Law 104–188, 110 Stat. 1755. Section 817A is effective for taxable years beginning after December 31, 1995. See Small Business Job Protection Act section 1612(c)(1).

Previous guidance on the matters addressed by these proposed regulations is provided in Notice 97–32, 1997–1 C.B. 420, which specifies the appropriate interest rate to be used during the temporary guarantee period of modified guaranteed contracts. Generally, the specified rate is the greater of the interest rate assumed by the insurance company to determine future guaranteed benefits or Moody's Corporate Bond Yield Average-Monthly Average Corporates (Moody's rate). For equity-indexed modified guaranteed contracts whose market value adjustment is based on the performance of stocks, other equity instruments or equity-based derivatives, the specified rate is obtained by multiplying whichever of the two rates is greater by 1.1. Notice 97–32 was to be effective pending the publication of further guidance. Comments received after publication of the Notice indicated the need for further consideration of the appropriate rate to be used.

Interest Rates Affecting Modified Guaranteed Contracts

These proposed regulations govern the interest rate to be used when life insurance companies issue certain modified guaranteed annuity and life insurance contracts. A modified guaranteed contract temporarily guarantees a higher return than the permanently guaranteed crediting rate, in exchange for shifting additional investment risk to the policyholder in the form of a market value adjustment. The temporary guarantee may be a fixed rate (non-equity-indexed modified guaranteed contracts) or a rate based on bond or equity yields (equity-indexed modified guaranteed contracts). During the temporary guarantee period, the amount paid to the policyholder upon surrender is increased or decreased by a market value adjustment, which is determined by a formula in the modified guaranteed contract. Modified guaranteed contracts can be issued out of a life insurance company's general account or one or more segregated accounts.

Section 817A provides special tax treatment for certain modified guaranteed contracts issued out of a segregated account. For this purpose, the term modified guaranteed contract is defined as an annuity, life insurance, or pension plan contract (other than a variable contract described in section 817) under which all or part of the amounts received under the contract are allocated to a segregated account. Assets and reserves in this segregated account must be valued from time to time with reference to market values for annual statement purposes. Further, a modified guaranteed contract must provide either for a net surrender value or for a policyholder's fund (as defined in section 807(e)(1)). If only a portion of a contract is not described in section 817, such portion is treated as a separate contract for purposes of applying section 817A.

The tax reserves for a modified guaranteed contract are computed under either sections 807(c)(3) or (d)(2), depending upon whether the reserves are also life insurance reserves as defined by section 816(b). If the reserves are not life insurance reserves, section 807(c)(3) provides that reserves for obligations under insurance and annuity contracts not involving life, accident, or health contingencies are computed using an appropriate rate of interest. The appropriate rate of interest is the highest (as of the time the obligation first did not involve life, accident, or health contingencies) of the following rates: (1) the applicable Federal interest rate (as defined in section 807(d)(2)(B)(i)); (2) the prevailing State assumed interest rate (as defined in section 807(d)(2)(B)(ii)); or (3) the rate of interest assumed by the insurance company to determine the contract's guaranteed benefit. Section 807(c) also provides that the reserves computed under section 807(c)(3) are never less than the net surrender value of the contract.

For a modified guaranteed contract that does give rise to life insurance reserves, as defined in section 816(b), reserves are computed under section 807(d). Under section 807(d)(1), the life insurance reserves for a contract cannot exceed the statutory reserves for the contract. Subject to that cap, a contract's life insurance reserves equal the greater of: (1) the contract's net surrender value; or (2) the contract's Federally prescribed reserve determined under section 807(d)(2).

Section 807(d)(2) provides that the Federally prescribed reserves for a contract are determined using: (1) the tax reserve method applicable to the contract; (2) the greater of the applicable Federal interest rate or the prevailing State assumed interest rate in effect on the date of the issuance of the contract; and (3) the prevailing commissioners' standard tables for mortality and morbidity. In the case of a life insurance contract covered by the Commissioners' Reserve Valuation Method (CRVM) or an annuity contract covered by the Commissioners' Annuities Reserve Valuation Method (CARVM), section 807(d)(3) provides that the tax reserve method applicable to a contract is the CRVM or CARVM prescribed by the National Association of Insurance Commissioners (NAIC), which is in effect on the date of the issuance of the contract.

Section 811(d) imposes an additional reserve computation rule for contracts that guarantee beyond the end of the taxable year payment or crediting of amounts in the nature of interest in excess of the greater of the prevailing state assumed interest rate or the applicable Federal interest rate. In those circumstances, section 811(d) requires that the contract's future guaranteed benefits be determined as though the interest in excess of the greater of the prevailing state assumed interest rate or the applicable Federal rate were guaranteed only to the end of the taxable year.

Required Interest

Section 812(b) defines the company's share of net investment income for the taxable year the computation of which also requires use of an interest rate. The company's share equals the excess, if any, of the net investment income over the sum of the policy interest (as defined in section 812(b)(2)) and the gross investment income's proportionate share of policyholder dividends (as defined in section 812(b)(3)) for the taxable year. Policy interest includes required interest on reserves under section 807(c) (other than section 807(c)(2) reserves), determined under section 812(b)(2)(A) by using the greater of the prevailing State assumed rate or the applicable Federal interest rate. If neither the prevailing State assumed interest rate nor the applicable Federal interest rate is used, another appropriate rate is used to calculate required interest.

Legislation Affecting Modified Guaranteed Contracts

The interest rates used for both reserves and required interest for modified guaranteed contracts are governed by section 817A. Under section 817A(e)(2), the IRS is authorized to determine annually the applicable interest rate to be used under sections 807(c)(3), 807(d)(2)(B) and 812 for a modified guaranteed contract. The IRS is authorized to exercise this authority by issuing a periodic announcement of the appropriate market interest rates or formula for determining such rates. H.R. Conf. Rept. No. 737, 104th Cong. 2d Sess. 313 (1996). Section 817A(e) also authorizes the IRS to modify or waive the application of section 811(d) (relating to interest guaranteed beyond the end of the taxable year), and to prescribe other regulations that are necessary or appropriate to carry out the purposes of section 817A.

The legislative history of section 817A indicates that an appropriate interest rate is a current market rate. H.R. Conf. Rep. No. 737, at 313. The interest rate may be determined, for example, using either a rate that is appropriate for the obligations under the contract to which the reserve relates or the yield on the assets underlying the modified guaranteed contract. In light of this legislative history and the purpose of section 817A, the statutory grant of authority to prescribe regulations to specify the appropriate interest rate is broad, granting discretion to the Secretary to determine that rate which will best match the obligations under modified guaranteed contracts to the market fluctuations of the underlying assets.

EXPLANATION OF PROVISIONS

This document contains proposed amendments to 26 CFR part 1 under sections 807, 811, 812, and 817A of the Internal Revenue Code (Code). These proposed rules specify the appropriate interest rates to be used by insurance companies in the determination of tax reserves under sections 807(c)(3) and (d)(2)(B), and the company's share of net investment income under 812(b)(2)(A), for certain modified guaranteed contracts, as defined in section 817A(d). It also describes the manner in which section 811(d) governing the calculation of reserves for certain insurance contracts is to be applied to these contracts. The proposed regulations do not adopt the position set forth in Notice 97–32, and instead provide that the appropriate interest rate for each non-equity-indexed modified guaranteed contract is the current market rate. These proposed regulations define the current market rate as the Treasury constant maturity interest rate published by the Board of Governors of the Federal Reserve System. The Treasury constant maturity interest rates are released each Monday as part of statistical release H.15, Selected Interest Rates, and can also be found at *http://www.federalreserve.gov/releases/#weekly*. Availability of the release is announced on (202) 452–3206. The proposed regulations do not take a position as to the appropriate interest rate to be used for an equity-indexed modified guaranteed contract whose market value adjustment is based on the performance of stocks, other equity instruments or equity-based derivatives.

The proposed regulations under section 817A, relating to the definition of the appropriate interest rate to be used in determining tax reserves under sections 807(c)(3) and (d)(2), the appropriate interest rate to be used under section

811(d), and required interest under 812(b)(2)(A), will be effective on the date that the regulations become final. However, pursuant to section 7805(b)(7), taxpayers will be permitted to apply the final regulations retroactively for all tax years beginning after December 31, 1995, the effective date of section 817A.

Effect on Other Documents

Notice 97–32 will not be revoked or superseded until final regulations are published in the Federal Register.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (preferably a signed original and eight (8) copies) or electronic comments that are timely submitted to the IRS. The IRS and Treasury specifically request comments on the clarity of the proposed regulations and how they can be made easier to understand. All comments will be available for public inspection and copying.

Comments are specifically requested on the use of a different current market rate for non-equity-indexed modified guaranteed contracts than the rate specified in these proposed regulations. Comments are also requested concerning the appropriate interest rate to use for equity-indexed modified guaranteed contracts. Any comments on these topics should address not only the definitions of such rates, but whether such approaches are presently in use among taxpayers, why such rates would produce superior measures of reserves and net income than the current market rate proposed in these regulations, and whether the use of such rates would produce simpler and less costly compliance burdens than the current market rate proposed in these regulations.

With regard to any comments submitted regarding non-equity-indexed modified guaranteed contracts that suggest the use of a insurer’s contract crediting rate offered for newly issued contracts with temporary guarantee periods equal in duration to the remaining duration of the temporary guarantee period of the original contract, several additional questions should be addressed. In the event the insurer does not offer modified guaranteed contracts with an identical temporary guarantee period as the temporary guarantee period remaining for the original contract, what rule should be used? If an interpolation of other rates should be used, what rule should be used? In the event interpolation is not meaningful because (1) the duration periods of the modified guaranteed contracts being newly issued are too dissimilar from the contract’s remaining duration, (2) there are not enough newly issued modified guaranteed contracts to make a reasonable interpolation, or (3) the insurer has ceased issuing modified guaranteed contracts, what rule should be used? For example, should the federal rate defined in section 1272(d) applicable for the number of years remaining in the temporary guarantee period of the contract be used?

Comments may also be submitted requesting that section 811(d) be modified or waived regarding modified guarantee contracts. The requested waiver or modification should include details on the implementation of any proposed rules.

Finally, if the application of the regulation for earlier tax years, once made final, requires clarification or amplification, affected taxpayers should detail their concerns and proposed solutions. All comments will be available for public inspection and copying in their entirety.

A public hearing has been scheduled for August 27, 2002, at 10 a.m., in Room 4718 in the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Because of access restrictions, visitors must enter at the main entrance, located at 1111 Constitution Avenue, NW. All visitors must present photo identification to enter the building and visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the “FOR FURTHER INFORMATION CONTACT” portion of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments, an outline of the topics to be discussed, and the time to be devoted to each topic (preferably a signed original and eight (8) copies) by August 6, 2002. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these proposed regulations is Ann H. Logan, Office of the Associate Chief Counsel (Financial Institutions and Products), Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the IRS and the Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.807–2 also issued under 26 U.S.C. 817A(e) * * *

Section 1.811–3 also issued under 26 U.S.C. 817A(e) * * *

Section 1.812–9 also issued under 26 U.S.C. 817A(e) * * *

Section 1.817A–1 also issued under 26 U.S.C. 817A(e) * * *

Par. 2. Section 1.807–2 is added to read as follows:

§ 1.807–2 Cross-Reference.

For special rules regarding the treatment of modified guaranteed contracts (as defined in section 817A and § 1.817A–1(a)(1)), see § 1.817A–1.

Par. 3. Section 1.811–3 is added to read as follows:

§ 1.811–3 Cross-Reference.

For special rules regarding the treatment of modified guaranteed contracts (as defined in section 817A and § 1.817A–1(a)(1)), see § 1.817A–1.

Par. 4. Section 1.812–9 is added to read as follows:

§ 1.812–9 Cross-Reference.

For special rules regarding the treatment of modified guaranteed contracts (as defined in section 817A and § 1.817A–1(a)(1)), see § 1.817A–1.

Par. 5. Sections 1.817A–0 and 1.817A–1 are added to read as follows:

§ 1.817A–0 Table of contents.

This section lists the captions that appear in section 1.817A–1:

§ 1.817A–1 Certain modified guaranteed contracts.

§ 1.817A–1 Certain modified guaranteed contracts.

(a) *Definitions*—(1) *Modified guaranteed contract*. The term *modified guaranteed contract* (MGC) is defined in section 817A(d) as an annuity, life insurance, or pension plan contract (other than a variable contract described in section 817) under which all or part of the amounts received under the contract are allocated to a segregated account. Assets and reserves in this segregated account must be valued from time to time with reference to market values for annual statement purposes. Further, an MGC must provide either for a net surrender value or for a policyholder's fund (as defined in section 807(e)(1)). If only a portion of a contract is not described in section 817, such portion is treated as a separate contract for purposes of applying section 817A.

(2) *Temporary guarantee period*. An MGC may temporarily guarantee a return other than the permanently guaranteed crediting rate for a period specified in the contract (the *temporary guarantee period*). During the temporary guarantee period, the amount paid to the policyholder upon surrender is usually increased or decreased by a market value adjustment, which is determined by a formula set forth under the terms of the MGC.

(3) *Equity-indexed modified guaranteed contract*. An equity-indexed MGC is an MGC, as defined in paragraph (a)(1) of this section, that provides a return during or at the end of the temporary guarantee period based on the performance of stocks, other equity instruments, or equity-based derivatives.

(4) *Non-equity-indexed modified guaranteed contract*. A non-equity-indexed MGC is an MGC, as defined in paragraph (a)(1) of this section, that provides a return during or at the end of the temporary guarantee period not based on the performance of stocks, other equity instruments, or equity-based derivatives.

(5) *Current market rate for non-equity-indexed modified guaranteed contracts*. The current market rate for a non-equity-indexed MGC issued by an insurer (whether issued in that tax year or a previous one) is the appropriate Treasury constant maturity interest rate published by the Board of Governors of the Federal Reserve System for the month containing the last day of the insurer's taxable year. The appropriate rate is that rate published for Treasury securities with the shortest published maturity that is greater than (or equal to) the remaining duration of the current temporary guarantee period under the MGC.

(6) *Current market rate for equity-indexed modified guaranteed contracts*. [Reserved]

(b) *Applicable interest rates for non-equity-indexed modified guaranteed contracts*—(1) *Tax reserves during temporary guarantee period*. An insurance company is required to determine the tax reserves for an MGC under sections 807(c)(3) or (d)(2). During a non-equity-indexed MGC's temporary guarantee period, the applicable interest rate to be used under sections 807(c)(3) and (d)(2)(B) is the current market rate, as defined in paragraph (a)(5) of this section.

(2) *Required interest during temporary guarantee period*. During the temporary guarantee period of a non-equity-indexed MGC, the applicable interest rate to be used to determine required interest under section 812(b)(2)(A) is the same current market rate, defined in paragraph (a)(5) of this section, that applies for that period for purposes of sections 807(c)(3) or (d)(2)(B).

(3) *Application of section 811(d)*. An additional reserve computation rule applies under section 811(d) for contracts that guarantee certain interest payments beyond the end of the taxable year. Section 811(d) is not modified or waived for the taxable year in which a non-equity-indexed MGC is issued. The current market rate, as defined in paragraph (a)(5) of this section, is to be applied to the remaining years of the MGC's temporary guarantee period.

(4) *Periods after the end of the temporary guarantee period*. For periods after the end of the temporary guarantee period, sections 807(c)(3), 807(d)(2)(B), 811(d) and 812(b)(2)(A) are not modified when applied to non-equity-indexed MGCs. None of these sections are affected by the definition of current market rate contained in paragraph (a)(5) of this section once the temporary guarantee period has expired.

(5) *Examples*. The following examples illustrate this paragraph (b):

Example 1. (i) *IC*, a life insurance company as defined in section 816, issues a MGC (the Contract) on August 1 of 1996. Assume that the conditions invoking the application of section 811(d) are not present. The Contract is an annuity contract that gives rise to life insurance reserves, as defined in section 816(b). *IC* is a calendar year taxpayer. The Contract guarantees that interest will be credited at 8 percent per year for the first 8 contract years and 4 percent per year thereafter. During the 8-year temporary guarantee period, the Contract provides for a market value adjustment based on changes in a published bond index and not on the performance of stocks, other equity instruments or equity based derivatives. *IC* has chosen to avail itself of the provisions of these regulations for 1996 and taxable years thereafter. The 10-year Treasury constant maturity interest rate published for December of 1996 was 6.30 percent. The next shortest maturity published for Treasury constant maturity interest rates is 7 years. As of the end of 1996, the remaining duration of the temporary guarantee period for the Contract was 7 years and 7 months.

(ii) To determine under section 807(d)(2) the end of 1996 reserves for the Contract, *IC* must use a discount interest rate of 6.30 percent for the temporary guarantee period. The interest rate to be used in computing required interest under section 812(b)(2)(A) for 1996 reserves is also 6.30 percent.

(iii) The discount rate applicable to periods outside the 8-year temporary guarantee period is determined under sections 807(c)(3), 807(d)(2)(B), 811(d), and 812(b)(2)(A) without regard to the current market rate.

Example 2. Assume the same facts as in *Example 1* except that it is now the last day of 1998. The remaining duration of the temporary guarantee period under the Contract is now 5 years and 7 months. The 7-year Treasury constant maturity interest rate published for December of 1998 was 4.65 percent. The next shortest duration published for Treasury constant maturity interest rates is 5 years. A discount rate of 4.65 percent is used for the remaining duration of the temporary guarantee period for the purpose of determining a reserve under section 807(d) and for the purpose of determining required interest under section 812(b)(2)(A).

Example 3. Assume the same facts as in *Example 1* except that it is now the last day of 2001. The remaining duration of the temporary guarantee period under the Contract is now 2 years and 7 months. The 3-year Treasury constant maturity interest rate published for December of 2001 was 3.62 percent. The next shortest duration published for Treasury constant maturity interest rates is 2 years. A discount rate of 3.62 percent is used for the remaining duration of the temporary guarantee period for the purpose of determining a reserve under section 807(d) and for the purpose of determining required interest under section 812(b)(2)(A).

(c) *Applicable interest rates for equity-indexed modified guaranteed contracts*. [Reserved.]

(d) *Effective date*. Paragraphs (a), (b) and (d) of this proposed regulation are effective on the date this notice is filed as a final regulation in the **Federal Register**. However, pursuant to section 7805(b)(7), taxpayers may elect to apply the final regulations retroactively for all taxable years beginning after December 31, 1995, the effective date of section 817A.

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on May 31, 2002, 8:45 a.m., and published in the issue of the Federal Register for June 3, 2002, 67 F.R. 38214)

Notice of Proposed Rulemaking

Diesel Fuel; Blended Taxable Fuel

REG–106457–00

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to the tax on diesel fuel and the tax on blended taxable fuel. These regulations affect persons that remove, enter, or sell diesel fuel or remove or sell blended taxable fuel.

DATES: Written and electronic comments and requests for a public hearing must be received by August 14, 2002.

ADDRESSES: Send submissions to: CC:ITA:RU (REG–106457–00), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:ITA:RU (REG–106457–00), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may submit electronic comments directly to the IRS Internet site at *www.irs.gov/regs.*

FOR FURTHER INFORMATION CONTACT: Concerning submissions, Sonya Cruse, (202) 622–7180; concerning the regulations, Frank Boland, (202) 622–3130 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background and explanation of provisions

Definition of Diesel Fuel.

Section 4081(a) of the Internal Revenue Code (Code) imposes a tax on certain removals, entries, and sales of taxable fuel. Taxable fuel means gasoline, diesel fuel, and kerosene. Section 4083 defines diesel fuel as any liquid (other than gasoline) that is suitable for use as a fuel in a diesel-powered highway vehicle or diesel-powered train. Existing regulations follow the Code provisions by providing that (with certain exceptions) diesel fuel is any liquid that, without further processing or blending, is suitable for such use. However, the existing regulations do not define the term *suitable for use*. The proposed regulations add to existing regulations by providing that a liquid is suitable for use as diesel fuel if the liquid has practical and commercial fitness for use in the propulsion engine of a diesel-powered highway vehicle or diesel-powered train.

Liability for Tax on Sale or Removal of Blended Taxable Fuel.

Blended taxable fuel is taxable fuel that is created by mixing a liquid that has not been taxed under section 4081 with previously taxed taxable fuel. Typically, this mixing occurs outside of the bulk transfer/terminal system. Under section 4081(b), tax is imposed on the removal or sale of the mixture (blended taxable fuel) by the blender thereof. Existing regulations provide that the blender is liable for this tax. Generally, the blender is the person that owns the mixture immediately after it is created. If the mixture is not taxable fuel because it is not suitable for use as a fuel in a diesel-powered highway vehicle or diesel-powered train, tax is imposed only if the mixture is delivered into the fuel supply tank of a diesel-powered highway vehicle or diesel-powered train. See section 4041(a).

The IRS has found that abusive situations exist with regard to the blending of diesel fuel. For example, untaxed liquids are sold as taxed diesel fuel to a retailer and delivered into the retailer's bulk storage tank that contains taxed diesel fuel. Under existing regulations, the retailer would be a blender and liable for tax on its removal or sale of the resulting mixture.

When the Congress enacted the present fuel tax regime, it noted that the Treasury Department is permitted "to prescribe rules and administrative procedures for determining liability for payment of tax." H.R. Conf. Rep. No. 101–964, at 1052 (1990). Thus, the Treasury Department may impose liability on persons other than the blender if that is necessary to prevent abuses and assure that the tax is, in fact, paid to the government.

Under these proposed regulations, a person would be jointly and severally liable for the section 4081(b) tax if the person sells a previously untaxed liquid as a taxed taxable fuel and that liquid becomes a part of a mixture that is blended taxable fuel.

Definition of Refinery.

The proposed regulations clarify that the term *refinery* generally includes any facility that produces taxable fuel.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because these regulations do not impose on small entities a collection of information requirement, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic and written comments that are submitted timely to the IRS. The IRS and Treasury Department specifically request comments on the clarity of the proposed regulations and how they may be made easier to understand. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is Frank Boland, Office of Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

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Proposed Amendments to the Regulations

Accordingly, 26 CFR part 48 is proposed to be amended as follows:

PART 48—MANUFACTURERS AND RETAILERS EXCISE TAXES

Paragraph 1. The authority citation for part 48 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 48.4081–1 is amended as follows:

1. Paragraph (b) is amended by removing the language "from crude oil, unfinished oils, natural gas liquids, or other hydrocarbons" in the first sentence of the definition of *Refinery.*

2. Paragraph (c)(2)(i) is amended by adding a sentence to the end.

The addition reads as follows:

§ 48.4081–1 Taxable fuel; definitions.

* * * * *

(c) * * *

(2) * * * (i) * * * A liquid is suitable for this use if the liquid has practical and commercial fitness for use in the propulsion engine of a diesel-powered highway vehicle or diesel-powered train.

* * * * *

Par. 3. Section 48.4081–3 is amended by revising paragraphs (g)(2) and (g)(3) to read as follows:

§ 48.4081–3 Taxable fuel; taxable events other than removal at the terminal rack.

* * * * *

(g) * * *

(2) *Liability for tax*—(i) *Liability of the blender*. The blender is liable for the tax imposed under paragraph (g)(1) of this section.

(ii) *Liability of seller of untaxed liquid*. On and after the date of publication of these regulations as final regulations in the **Federal Register**, a person that sells any liquid that is used to produce blended taxable fuel is jointly and severally liable for the tax imposed under paragraph (g)(1) of this section on the removal or sale of that blended taxable fuel if the liquid—

(A) Is described in § 48.4081–1(c)(1)(i)(B) (relating to liquids on which tax has not been imposed under section 4081); and

(B) Is sold by that person as gasoline, diesel fuel, or kerosene that has been taxed under section 4081.

(3) *Examples*. The following examples illustrate the provisions of this paragraph (g) and the definitions of *blended taxable fuel* and *diesel fuel* in § 48.4081–1(c):

Example 1. (i) *Facts*. W is a wholesale distributor of petroleum products and R is a retailer of petroleum products. W sold to R 1,000 gallons of an untaxed liquid (a liquid described in § 48.4081–1(c)(1)(i)(B)) and delivered the liquid into a storage tank (tank) at R's retail facility. However, W's invoice to R stated that the liquid is undyed diesel fuel. At the time of the delivery, the tank contained 4,000 gallons of undyed diesel fuel, a taxable fuel that has been taxed under section 4081. The resulting 5,000 gallon mixture is suitable for use as a fuel in a diesel-powered highway vehicle because it has practical and commercial fitness for use in the propulsion engine of a diesel-powered highway vehicle.

The mixture does not satisfy the dyeing requirements of § 48.4082–1. R sold the mixture from the tank to a construction company for off-highway business use.

(ii) *Analysis*—(A) *Production of blended taxable fuel*. R is a blender within the meaning of § 48.4081–1 because R has produced blended taxable fuel, as defined in § 48.4081–1, by mixing 4,000 gallons of diesel fuel that has been taxed under section 4081 with 1,000 gallons of a liquid that has not been taxed under section 4081. The mixing occurred outside of the bulk transfer/terminal system and the resulting product is diesel fuel because it is suitable for use as a fuel in a diesel-powered highway vehicle.

(B) *Imposition of tax*. Under paragraph (g)(1) of this section, tax is imposed on R's sale of the 5,000 gallons of blended taxable fuel to the construction company. Even though the blended taxable fuel is sold for off-highway business use, which is a nontaxable use as defined in section 4082(b), the sale is not exempt from tax because the blended taxable fuel does not satisfy the dyeing requirements of § 48.4082–1. Tax is computed on 1,000 gallons, which is the difference between the number of gallons of blended taxable fuel sold by R (5,000) and the number of gallons of previously taxed taxable fuel used to produce the blended taxable fuel (4,000).

(C) *Liability for tax*. R, as the blender, is liable for this tax under paragraph (g)(2)(i) of this section. W is jointly and severally liable for this tax under paragraph (g)(2)(ii) of this section because the blended taxable fuel was produced using an untaxed liquid that W sold as undyed diesel fuel (that is, as diesel fuel that was taxed under section 4081).

Example 2. (i) *Facts*. W, a wholesale distributor of petroleum products, bought 7,000 gallons of diesel fuel at a terminal rack. The diesel fuel was delivered into a tank trailer. Tax was imposed on the diesel fuel under § 48.4081–2 when the diesel fuel was removed at the rack. W then went to another location where X, the operator of a chemical plant, sold W 1,000 gallons of an untaxed liquid (a liquid described in § 48.4081–1(c)(1)(i)(B)). However, X's invoice to W stated that the liquid is undyed diesel fuel. This liquid was delivered into the tank trailer already containing the 7,000 gallons of diesel fuel. The resulting 8,000 gallon mixture is suitable for use as a fuel in a diesel-powered highway vehicle because it has practical and commercial fitness for use in the propulsion engine of a diesel-powered highway vehicle. The mixture does not satisfy the dyeing requirements of § 48.4082–1. W sold the mixture to R, a retailer of petroleum products, and delivered the mixture into a storage tank at R's retail facility. R sold the mixture to its customers.

(ii) *Analysis*—(A) *Production of blended taxable fuel*. W is a blender within the meaning of § 48.4081–1 because W produced blended taxable fuel, as defined in § 48.4081–1, by mixing 7,000 gallons of diesel fuel that was taxed under section 4081 with 1,000 gallons of a liquid that was not taxed under section 4081. The mixing occurred outside of the bulk transfer/terminal system and the resulting product is diesel fuel because it is suitable for use as a fuel in a diesel-powered highway vehicle. Thus, R bought blended taxable fuel.

(B) *Imposition of tax*. Under paragraph (g)(1) of this section, tax is imposed on W's sale of the 8,000 gallons of blended taxable fuel to R. Tax is computed on 1,000 gallons, which is the difference between the number of gallons of blended taxable fuel sold by W (8,000) and the number of gallons of previously taxed taxable fuel used to produce the blended taxable fuel (7,000). No tax is imposed on R's subsequent sale of the blended taxable fuel because tax is imposed only with respect to a removal or sale by the blender.

(C) *Liability for tax*. W, as the blender, is liable for this tax under paragraph (g)(2)(i) of this section. X is jointly and severally liable for this tax under paragraph (g)(2)(ii) of this section because the blended taxable fuel sold by W was produced using a previously untaxed liquid X sold to W as undyed diesel fuel, a taxed taxable fuel. R has no liability for tax because R is not a blender and did not sell any untaxed liquid as a taxed taxable fuel. R only sells previously taxed taxable fuel, the blended taxable fuel bought from W.

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Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on May 15, 2002, 8:45 a.m., and published in the issue of the Federal Register for May 16, 2002, 67 F.R. 34882)

Notice of Proposed Rulemaking

Carryback of Consolidated Net Operating Losses to Separate Return Years

REG–122564–02

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of Proposed Rulemaking.

SUMMARY: This document contains proposed regulations under section 1502 that affect corporations filing consolidated returns. In the Rules and Regulations section of this issue of the **Federal Register**, the IRS is issuing temporary regulations permitting certain acquiring consolidated groups to elect to waive all or a portion of the pre-acquisition portion of the 5-year carryback period under section 172(b)(1)(H) for certain losses attributable to certain acquired members. The text of those regulations also serves as the text of these proposed regulations.

DATES: Written or electronic comments and requests for a public hearing must be received by July 30, 2002.

ADDRESSES: Send submissions to: CC:ITA:RU, room 5226 (REG–122564–02), Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may also be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:ITA:RU, room 5226 (REG–122564–02), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet directly to the IRS Internet site at *www.irs.gov/regs.*

FOR FURTHER INFORMATION CONTACT: Concerning the regulation, Marie C. Milnes-Vasquez (202) 622–7770; concerning submissions and/or requests for a public hearing, Guy Traynor (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the **Office of Management and Budget** for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, W:CAR: MP:FP:S, Washington, DC 20224. Comments on the collection of information should be received by July 30, 2002. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collections of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collection of information in this proposed regulation is in § 1.1502–21(b)(3)(ii)(C). This information is required to document the taxpayer's election to relinquish portions of its carryback period for 2001 and 2002 losses attributable to acquired members. The data will be used by the Internal Revenue Service to ensure that taxpayers are preparing their returns in accordance with their elections. The collection of information is required to obtain a benefit. The likely respondents are businesses.

Estimated total annual reporting burden: 1,000 hours.

Estimated average annual burden hours per respondent: 15 minutes.

Estimated number of respondents: 4,000.

Estimated annual frequency of responses: Once.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background and Explanation

Temporary regulations in this issue of the Bulletin amend the Income Tax Regulations (26 CFR part 1) relating to section 1502. The temporary regulations provide rules permitting certain acquiring consolidated groups to elect to waive all or a portion of the pre-acquisition portion of the 5-year carryback period under section 172(b)(1)(H) for certain losses attributable to certain acquired members. The text of those regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the amendments.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations do not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations principally affect persons filing consolidated Federal income tax returns. Available data indicates that most consolidated return filers are large companies (not small businesses). Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are timely submitted to the IRS. All comments will be made available for public inspection and copying. A public hearing may be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register.**

Drafting Information

The principal author of these proposed regulations is Marie C. Milnes-Vasquez, Office of the Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

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Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended to read as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.1502–21 is amended by adding paragraph (b)(3)(ii)(C) to read as follows:

§ 1.1502–21 Net operating losses.

[The text of proposed § 1.1502–21(b)(3)(ii)(C) is the same as the text of § 1.1502–21T(b)(3)(ii)(C) published elsewhere in this issue of the **Federal Register**].

David A. Mader,
Acting Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on May 30, 2002, 8:45 a.m., and published in the issue of the Federal Register for May 31, 2002, 67 F.R. 38039)

Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations and Notice of Public Hearing

Loss Limitation Rules

REG–123305–02

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations and notice of public hearing.

SUMMARY: This document contains proposed amendments to temporary regulations issued under sections 337(d) and 1502. The amendments clarify certain aspects of the temporary regulations relating to the deductibility of losses recognized on dispositions of subsidiary stock by members of a consolidated group. The proposed amendments in these proposed regulations apply to corporations filing consolidated returns, both during and

after the period of affiliation, and also affect purchasers of the stock of members of a consolidated group. The text of the temporary regulations (T.D. 8998) published in this issue of the Bulletin also serves as the text of these proposed regulations. This document also provides notice of a public hearing on these regulations.

DATES: Written or electronic comments must be received by July 10, 2002. Requests to speak (with outlines of oral comments to be discussed) at the public hearing scheduled for July 17, 2002, at 10 a.m., must be received by June 26, 2002.

ADDRESSES: Send submissions to: CC:ITA:RU (REG–102740–02), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 6 p.m. to CC:ITA:RU (REG–102740–02), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20044. Alternatively, taxpayers may submit electronic comments directly to the IRS Internet site at *www.irs.gov/regs*. The public hearing will be held in the Internal Revenue Service Auditorium, in the Internal Revenue Service Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Sean P. Duffley, (202) 622–7530, or Lola L. Johnson, (202) 622–7550; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, LaNita VanDyke (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been previously reviewed and approved by the Office of Management and Budget under control number 1545–1774. No material changes to these collections of information are proposed in these regulations.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

Temporary regulations in this issue of the Bulletin amend 26 CFR part 1 relating to sections 337(d) and 1502. The text of those regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations contains a full explanation of the reasons underlying the issuance of these proposed regulations.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations do not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations will primarily affect affiliated groups of corporations that have elected to file consolidated returns, which tend to be larger businesses, and, moreover, that any burden on taxpayers is minimal. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic and written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. All comments will be available for public inspection and copying. A public hearing has been scheduled for July 17, 2002, at 10 a.m., in the IRS Auditorium, IRS Building, 1111 Constitution, NW, Washington, DC. Because of access restrictions, visitors will not be admitted beyond the building lobby more than 30 minutes before the hearing starts.

Drafting Information

The principal authors of these regulations are Sean P. Duffley and Lola L. Johnson, Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury participated in their development.

* * * * *

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entry for "Section 1.1502–20T(i)" and adding an entry in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.1502–20 also issued under the authority of 26 U.S.C. 337(d) and 1502. * * *

Par. 2. In § 1.337(d)–2, paragraphs (a)(4) and (b)(4) are added to read as follows:

§ 1.337(d)–2 Loss limitation window period.

[The text of this proposed section is the same as the text of § 1.337(d)–2T published elsewhere in this issue of the **Federal Register**].

Par. 3. Section 1.1502–20 is amended by revising paragraphs (i)(3)(v) and (i)(4) to read as follows:

§ 1.1502–20 Disposition or deconsolidation of subsidiary stock.

[The text of this proposed section is the same as the text of § 1.1502–20T published elsewhere in this issue of the **Federal Register**].

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on May 30, 2002, 8:45 a.m., and published in the issue of the Federal Register for May 31, 2002, 67 F.R. 38040)

Announcement 2002–59

New Publications Reflect Tax Law Changes

Four new publications are available from the Internal Revenue Service reflecting changes enacted by the Job Creation and Worker Assistance Act of 2002.

Publication 3991, *Highlights of the Job Creation and Worker Assistance Act of 2002*, provides information about tax law changes that affect many individuals and businesses. Some of the tax law changes from the Job Creation and Worker Assistance Act of 2002 took effect retroactively for 2001 and others take effect in 2002 and later years.

Supplement to Publication 463, *Travel, Entertainment, Gift, and Car Expenses*, provides information for taxpayers who purchased a car for business purposes after September 10, 2001. If you use the actual car expense method to deduct expenses for the business use of your car, you may qualify for the new special depreciation allowance. This allowance is a deduction equal to 30% of the car's depreciable basis. This supplement explains how to claim (or elect to not claim) the allowance for 2001.

Supplement to Publication 536, *Net Operating Losses (NOLs) for Individuals, Estates, and Trusts*, provides information about the new 5-year NOL carryback period for tax years ending in 2001 or 2002. This supplement also explains how taxpayers who have already filed their return for a tax year ending during 2001 or 2002 and did not apply the new 5-year carryback will have an opportunity to do so by October 31, 2002.

Supplement to Publication 946, *How To Depreciate Property*, provides information about changes to the tax rules explained in Publication 946 for certain qualified property placed in service after September 10, 2001, including a new special depreciation allowance, an increased dollar limit on the section 179 deduction, a shorter recovery period for certain property, and an increase in the maximum depreciation deduction for 2001 for a passenger automobile. This supplement explains changes to the law that may reduce your taxes for 2001.

You can get a copy of these publications by calling 1–800–TAX-FORM (1–800–829–3676). You can also write to the Distribution Center nearest to you. Check your income tax package for the address. These publications are also available on the IRS Internet web site at *www.irs.gov*.

Extension of Test of Arbitration Procedure for Appeals

Announcement 2002–60

SUMMARY: This document modifies and extends the test of the arbitration procedure set forth in Announcement 2000–4, 2000–1 C.B. 317, for an additional one-year period beginning on July 1, 2002, the date this announcement is published in the Internal Revenue Bulletin.

This procedure allows taxpayers to request binding arbitration for **factual** issues that are already in the Appeals process. Under the procedure set forth in Announcement 2000–4, the taxpayer and Appeals must first attempt to negotiate a settlement. If those negotiations are unsuccessful, the taxpayer and Appeals may jointly request binding arbitration.

BACKGROUND: Appeals concluded a two-year test of the arbitration procedure on January 17, 2002. During this period, Appeals received five requests for arbitration, four of which Appeals approved. The arbitration program is consistent with IRS' efforts to improve tax administration, provide customer service, and reduce taxpayer burden. During the additional one-year test period, Appeals will seek additional cases for arbitration to further evaluate the program.

CHANGES: Changes to Announcement 2000–4 made by this announcement include:

- Issues involving the substantiation of expenses under § 162 of the Internal Revenue Code, Trade or Business Expenses, or § 274, Disallowance of Certain Entertainment, Etc., Expenses, are now eligible for arbitration.
- Arbitration is now available for an issue for which the taxpayer intends to seek competent authority assistance, provided a request for competent authority assistance has not as yet been filed. In such a case, the taxpayer may not request competent authority assistance until the arbitration process is completed. However, competent authority assistance may be requested while arbitration is pending if such request is necessary to keep open a statute of limitations in the treaty country. In such a case, the U.S. competent authority will suspend action on the case until arbitration is competed. Arbitration is not available for an issue for which the taxpayer has requested competent authority assistance or the simultaneous Appeals/Competent Authority procedure described in section 8 of Rev. Proc. 96–13, 1996–1 C.B. 616, or any subsequent revenue procedure. **Taxpayers are cautioned that if they enter into a settlement with Appeals (including an Appeals settlement through the arbitration process), and then request competent authority assistance, the U.S. competent authority will endeavor only to obtain a correlative adjustment with the treaty country and will not take any actions that would otherwise amend the settlement. *See* section 7.05, Rev. Proc. 96–13.**
- The arbitration procedure now includes the following express timelines to complete the agreement to arbitrate and proceed to arbitration. Generally, it is expected that the parties will complete the agreement to arbitrate within four weeks after the taxpayer is notified that Appeals has approved the arbitration request, and proceed to arbitration within 90 days after signing the agreement to arbitrate. A taxpayer's inability to adhere to these timeframes, without reasonable cause, may result in Appeals' withdrawal from the arbitration process.
- The arbitration procedure excludes Collection cases.
- The arbitration procedure excludes issues for which arbitration would not be consistent with sound tax administration, *e.g.* issues governed by closing agreements, by *res judicata*, or controlling Supreme Court precedent.

- The arbitration procedure excludes frivolous issues, such as, but not limited to, those identified in Rev. Proc. 2001–41, 2001–33 I.R.B.173.
- The arbitration procedure excludes cases where the taxpayer did not act in good faith during settlement negotiations, *e.g.*, failure to respond to document requests, failure to respond timely to offers to settle, failure to address arguments and precedents raised by Appeals.
- Since the publication of Announcement 2000–4, Appeals has reorganized its staffing. Therefore, position and office titles in Announcement 2000–4 are substituted as follows, along with an updated mailing address for Headquarters Appeals:

Position Title Changes

Old	*New*
National Director of Appeals	National Chief, Appeals
Assistant Regional Director of Appeals (ARDA-LC)	Area Director
Appeals Associate Chief	Appeals Team Manager
Appeals Team Chief	Appeals Team Case Leader

Office Title Changes

Old	*New*
National Director of Appeals Attn: C:AP:ADR&CS 1099 14th Street, N.W. Suite 4200 - East Washington, DC 20005	National Chief, Appeals Attn: Appeals Large Business and Specialty Programs - Operations 1099 14th Street, N.W. Suite 4200 - East Washington, DC 20005
National Office Appeals	Headquarters Appeals
Appeals Region	Appeals Area
Office of Alternative Dispute Resolution and Customer Service Programs	Appeals Large Business and Specialty Programs - Operations

In addition to the above changes, responsibility for the management of the Appeals arbitration program has been transferred from the Office of Alternative Dispute Resolution and Customer Service Programs to Appeals Large Business and Specialty Programs - Operations.

EFFECTIVE DATE: This procedure is effective July 1, 2002, the date this announcement is published in the Internal Revenue Bulletin.

EFFECT ON OTHER DOCUMENTS: This announcement modifies and extends the test of the arbitration procedure set forth in Announcement 2000–4.

DRAFTING INFORMATION: The principal author of this announcement is Sandy Cohen, of the office of Appeals Large Business and Specialty Programs - Operations, Headquarters Appeals. For further information regarding this announcement, contact Mr. Cohen at (202) 694–1818 (not a toll-free call).

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as"rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign Corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Intemal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statements of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

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[2] A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2001–27 through 2001–53 is in Internal Revenue Bulletin 2002–1, dated January 7, 2002.

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Key to Abbreviations:

Ann	Announcement
CD	Court Decision
DO	Delegation Order
EO	Executive Order
PL	Public Law
PTE	Prohibited Transaction Exemption
RP	Revenue Procedure
RR	Revenue Ruling
SPR	Statement of Procedural Rules
TC	Tax Convention
TD	Treasury Decision
TDO	Treasury Department Order

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